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Bloomberg Businessweek

Why Won't You Let This Man Invest Your Money?



There's $9 trillion on the sidelines. Charles Schwab is pleading for people to jump into "the most violent" market he's ever seen. What does he know that they don't? p58



2010 Toyota Camry LE

MPG: 32 – EPA est hwy

2010 IIHS Top Safety Pick: no*

Powertrain Warranty: 5 years/60,000 miles**

Automatic Crash Response: not available

Turn-by-Turn Navigation: optional

*Malibu models built after November 11, 2009. Visit IIHS.org for complete details on IIHS segmentation and testing results.
**Whichever comes first. See dealer for limited warranty details. †Visit onstar.com for details and system limitations.



2010 Chevy Malibu LTZ

MPG: 33 – EPA est hwy

2010 IIHS Top Safety Pick: yes*

Powertrain Warranty: 5 years/100,000 miles**

Automatic Crash Response: OnStar®/1 year standard†

Turn-by-Turn Navigation: OnStar/1 year standard

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FOCUS on driving

Opening Remarks

When Banks Don't Trust Banks

Credit markets are misbehaving again. But having survived the panic of 2008, investors may no longer be so easily rattled.
By Pierre Paulden

As Europe's sovereign debt crisis shows signs of turning into a contagion, infecting everything from interbank lending rates in London to the U.S. junk bond market, credit markets are experiencing déjà vu. The almost $1 trillion pledged by European finance ministers this month to bolster the region's finances has failed to mollify investors who worry that euro zone trouble could cause another Lehman-like disruption in worldwide financial markets.

A primary cause for concern now, as then, is the banks. Independent Credit View, a Swiss rating company, estimates that global banks may have a capital deficit of more than $1.5 trillion by the end of 2011 and some may need state help to survive. Libor, the short-term rate at which banks lend to one another, has shot up to 0.538 percent, the highest since July; it was less than half that as recently as March. Other types of short-term IOUs also show strain, with financial companies having to pay an average rate of 0.47 percent on 90-day commercial paper, the highest in a year, Federal Reserve data show. "Failure is not off the table for large financials," says Brian Yelvington, head of fixed-income strategy at Knight Libertas in Greenwich, Conn.

Just a few weeks ago, the credit markets were almost back to pre-Lehman normality. Investors were asking precious little of the borrowers they shoveled money at. As of mid-May, 60 percent of high-yield borrowers were able to get away with weaker investor safeguards on new debt, according to Covenant Review, a New York-based research firm that analyzes bond offerings. Caps were removed on the amount of debt companies can carry, and fewer restrictions were placed on using assets as collateral for future borrowing, effectively reducing what's available to satisfy creditor claims in a bankruptcy. All of these were symptoms of a larger phenomenon that many viewed as healthy: An appetite for risk had returned.

That now appears to have been premature. Though Lehman-style panic has not set back in, market conditions are, to say the least, fraught. Issuance of corporate debt has slowed considerably, falling from $183 billion in April to $53 billion in May, the lowest monthly total since December 1999, according to Bloomberg data. More than 19 companies have delayed or postponed $5 billion of debt deals since Apr. 13, with immediate consequences for corporate spending. Allegiant Travel, a Las Vegas-based passenger airline, was forced to put off a $250 million bond offering that it planned to use to pay for MD-80 and Boeing 757 aircraft already under contract. Jones Apparel Group, a New York-based retailer, pulled a $250 million bond offering that was going to help it acquire a majority stake in shoe designer Stuart Weitzman Holdings. Meanwhile, companies able to raise new debt have to pay a richer premium over benchmark government securities, adding up to 1.96 percentage points, an increase of 0.47 since the end of April. That's the biggest monthly jump since October 2008, a month after Lehman Brothers collapsed. There is carnage in the market for junk bonds, which slid 4.56 percent this month, their worst performance since dropping 8.43 percent in October 2008.

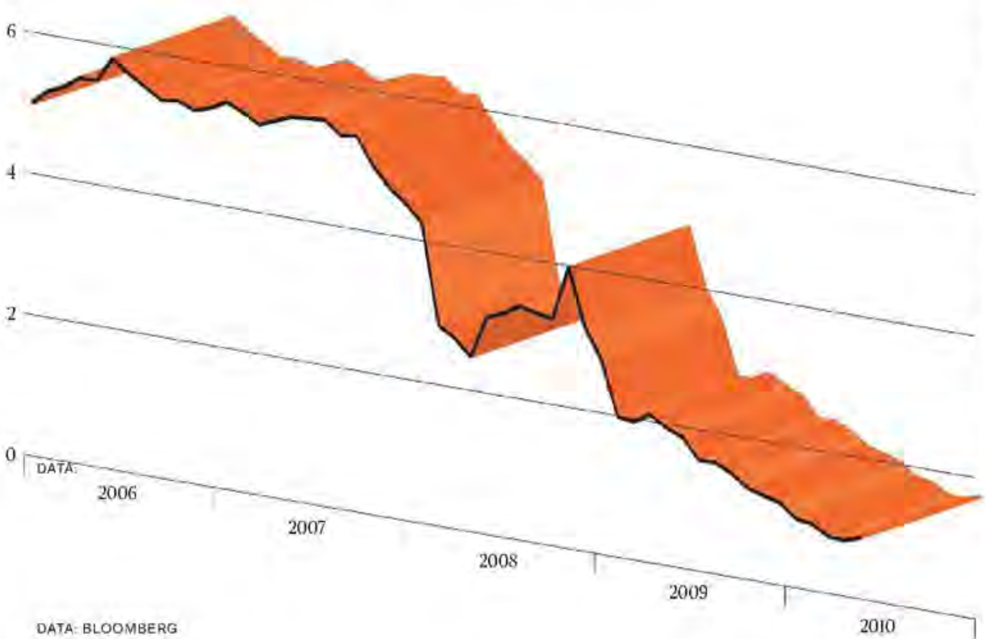
Libor has shot up to 0.538 percent since July and could hit 1.5 percent by September

The silver lining is that while bond investors are fleeing credit markets, they are moving into Treasuries, pushing up prices and lowering the government's borrowing cost. The yield on the benchmark 10-year Treasury note fell to 3.06 percent this week, down from 4 percent in April. Among other felicitous effects, that has pushed down mortgage rates and aided the fragile recovery of the national housing market; homeowners can now get a standard 30-year mortgage at 4.85 percent, down from 5.26 percent in early April, according to Bankrate.com in North Palm Beach, Fla., spurring a new flurry of refinancing and boosting new-home sales by 15 percent to their highest levels since May 2008.

Lower rates have also brought down borrowing costs for companies fortunate enough to live at the top of the credit food chain. Abbott Laboratories, maker of the lucrative arthritis drug Humira, sold $3 billion of bonds on May 24, its first offering in more than a year. The coupon on the biggest portion of the deal, a $1.25 billion slice due in 2040, was 5.3 percent, a full percentage point lower than similarly rated bonds due in more than 15 years, based on Bank of America Merrill Lynch index data. "There is a flight to quality, to solid investment-grade companies," says

Ride the Libor

The interest rate at which banks lend to one another has recently ticked up but is still well off its highs



DATA: BLOOMBERG

Nicholas Pappas, co-head of flow credit trading in the Americas at Deutsche Bank in New York.

Even high-yield debt still has fans—or at least bargain hunters willing to swoop in when they spot an attractive price. After junk bonds gained a record 57.5 percent in 2009 and 7.1 percent through April of this year, the market is "correcting," says Jeff Peskind, founder of hedge fund Phoenix Investment Adviser in New York. He scooped up the bonds of credit-card processor First Data and other large leveraged buyouts as prices tumbled this month, anticipating a rebound. First Data, bought by KKR & Co. for $27.5 billion, has seen its bonds decline 17.5 percent this month through May 25, raising concerns among investors about the Atlanta-based company's ability to roll over the $14.3 billion of loans and bonds it has coming due by 2014.

First Data is not alone. Junk-rated borrowers, some of whom were taken private at the height of the leveraged buyout boom in 2007, have $1.25 trillion of debt coming due through 2015. Their prospects are, at best, mixed. "LBOs need growth to de-lever. They also need access to capital markets to continue pushing out maturities," says Jason Rosiak, the head fund manager overseeing $2.7 billion at Pacific Asset Management, an affiliate of Pacific Life Insurance in Newport Beach, Calif.

The bright side to the retreat from bonds: A rush to Treasuries is pushing mortgage rates down

As for the ol' Libor, well, it could get worse before it gets better. Deepening concern about the quality of banks' collateral and attempts to regulate the banking industry could force it as high as 1.5 percent by September, says Neela Gollapudi, a strategist at Citigroup Global Markets in New York.

That's still a safe distance from its peak. Thus far, market participants tend to agree on one point—if the European debt crisis is a contagion, it will probably not lead back into full-blown panic. The recent experience of a brutal, worldwide, coordinated market plunge left calluses, as well as a resolve not to be left out of the next buying opportunity of a lifetime. A lesson from 2008 is that those with the nerve to wade back into markets at their scary lows can reap remarkable profits; just because some investors head for the exits doesn't mean there will be a mad scramble. As Morgan Stanley strategists Laurence Mutkin and Elaine Lin put it in a May 26 report: "The repricing of spreads in financing markets, sharp and swift though it has been, still does not amount to evidence of anything like the levels of stress during 2008. Nor, given that central banks have already revived their backstop measures, do we think that it will. Financing markets remain orderly and open." Ⓑ —*With Tim Catts and Shannon Harrington*


WHO HAS THE CAPITAL
TO INVEST IN A DOWNTURN?
THOSE WHO INVESTED
IN THE LAST ONE.
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Global Economics



Discounts in New York City; pricing power is weak

BRIAN SHUMWAY/REDUX

Funny, It Doesn't Feel Like a Recovery

▶ The rebound is not yet strong enough to dispel the threat of deflation

▶ "Call it a nightmare," says one prominent bear

Bargains are everywhere in America these days. Men's shirts and sweaters were 3.4 percent cheaper this April than a year earlier. Prices also fell for eggs, peanut butter, bananas, potatoes, hotel and motel rooms, cosmetics, curtains, rugs, tools, and lawn care. Excluding gasoline and other energy items, the consumer price index rose just 0.9 percent for the year. That's the smallest increase since January 1962, when John F. Kennedy was President.

Everybody likes to save money, but flat to falling prices are not entirely good. They're a symptom of continued weakness nearly a year after the U.S. economy supposedly hit bottom. The same softness of demand that keeps goods cheap is pressuring workers. Annual growth of average hourly earnings fell from 3.5 percent in April 2007 to 1.6 percent this April.

The economic recovery, while welcome, isn't yet strong enough to ensure against the risk of deflation, in which prices fall across the board for an extended period. Deflation caused by a shortfall in demand can be dangerous. People delay purchases, waiting for lower prices, which exacerbates the slowdown. Bankruptcies rise because even though pay falls, debt levels don't. To keep deflation at bay, the Federal Reserve's Open Market Committee voted in April to keep the federal funds rate at near zero. Even with an overhang of more than $1 trillion of excess reserves in the banking system, ready to be lent, committee members cut their inflation forecasts by 0.2 percentage point between the January and April meetings, to a range of 1.2 percent to 1.5 percent for this year.

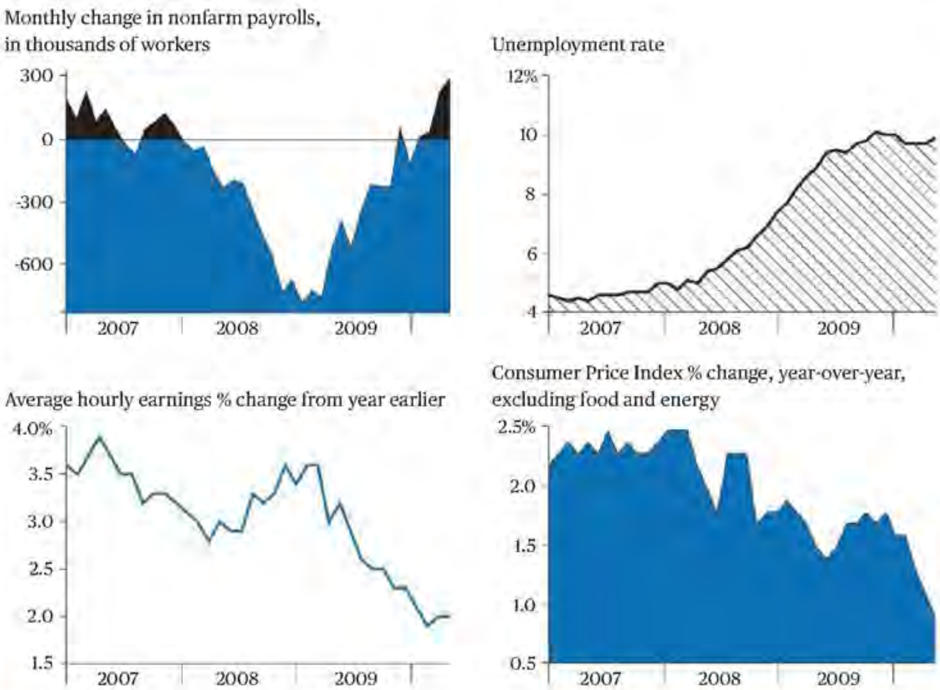
Turmoil in Europe is amplifying the risk of deflation in the U.S. It's driving up the dollar's value, making

Wal-Mart's new logistics strategy page 17 ▶



Yes, Payrolls Are Rising Again

But economic weakness could still trigger deflation



DATA: BUREAU OF LABOR STATISTICS

American goods less competitive in world markets and retarding growth. Europe's problems also are pushing down the U.S. stock market, which makes consumers fearful and less likely to spend. The Standard & Poor's 500-stock index has fallen 12 percent from its April high. A sharp decline in oil prices since the end of April shows that growth worries are worldwide, since it's global demand that determines the price of oil. Crude hit $71 a barrel in late May, down from $86 at the end of April. Gold is moving the other way, rising to more than $1,200 an ounce by late May from a recent low of less than $900 in April 2009, as investors seek a refuge from chancy markets and banks. All the grim indicators have made their mark. "Call it a nightmare," says one of the most prominent bears, David A. Rosenberg, chief economist and strategist at the Toronto-based investment firm of Gluskin Sheff + Associates.

The decline of output during the 2007-09 recession was so steep that there's still a huge amount of excess productive capacity. According to Federal Reserve data, only 69 percent of total industry capacity was used in April, vs. an average of 81 percent in the previous 38 years. As for labor, the unemployment rate remains stubbornly high because every uptick in hiring encourages more people to start looking for work again—and thus boost the official jobless rate.

The optimistic take on the economy is that the threat of deflation is temporary and will diminish as excess capacity gets eaten up. Kurt Karl, chief U.S. economist of Swiss Re, says employment gains are producing income that will be spent, generating more jobs and more spending in a virtuous upward spiral. "I'm still bullish," says Karl, adding, "employment growth has turned a major corner." Deflation, he adds, "would be a permanent kind of problem only if you didn't have any employment momentum." He predicts a decrease in the unemployment rate from 9.9 percent in April to about 9.5 percent at the end of 2010 and about 8 percent at the end of 2011.

Certainly there are some signs of progress. On May 25 the Conference Board announced that its May index of consumer confidence rose to the highest level since March 2008. MasterCard Advisors' SpendingPulse measure of consumer purchases has ticked up sharply since early 2009. Luxury retail chains including **Barneys** and **Saks** are scaling back discounts and promotions they offered to attract shoppers during the recession. In February, **Tiffany** raised prices across the store. Consultants Bain & Co. say U.S. sales of luxury goods may rise 4 percent in 2010 after declining 17 percent in 2009.

There are worrisome signs, though, that the recovery could stall. Employment has been boosted by the Census Bureau's temporary hiring for the decennial census, but as summer approaches that source of employment will fade. Job creation will slow as the year goes on and be "anemic" in 2011, predicts Rajeev Dhawan, director of the Economic Forecasting Center at Georgia State University's J. Mack Robinson College of Business. Says Sumit Chandra, a supply chain expert who is a partner at A.T. Kearney consultants: "The recovery is real. It's happening. But I think the magnitude of the recovery, the level of confidence we have in it, is fragile."

Kelly Services, the temporary help firm, sees the tentativeness of the expansion at ground level. Demand for its services is strong because companies "want to maintain maximum flexibility" in case the recovery fades, says George S. Corona, Kelly's executive vice-president. Meanwhile, upward pressure on wages is nil in most segments, says Corona. "We have a lot of résumés coming in the door," he says. "We're not having to work hard to find people." Exactly. Cheap shirts and sweaters are cold comfort for unemployed people who are sitting at home in their pajamas.

—Peter Coy, with Cotten Timberlake

The bottom line *The recession created so much extra capacity that the economy is struggling to absorb it, even as the recovery takes hold.*

Quoted

"I think we're in a period where the S&P could decline by another 10 to 15 percent. But I don't think we'll see new lows because the market's decline will give the Fed an excuse again to print money."



—Marc Faber, publisher, *The Gloom Boom & Doom Report*, a newsletter



Europe

Luxembourg Gets EU Donor Fatigue

▶ Its per capita contributions to the bailout dwarf Germany's

▶ "It makes you wonder whether the whole Europe thing is good"

The bailout of Greece is costing the 16 countries in the euro zone some $100 billion. Germany, the area's biggest economy, will pay almost 30 percent of the total, much to the dismay of many of its taxpayers.

A look at the contributions per capita, however, yields a different picture. The tiny Grand Duchy of Luxembourg will offer emergency loans worth 417.54 euros ($517.79) a person to bail out Greece, the biggest per capita contribution to the package. The second-biggest giver is Ireland, at $369 per capita—even though Ireland's economy is just shedding its basket-case status. Germany comes in sixth at $335 per capita.

The contributions to the rescue fund are based on the capital levels that each country holds in the **European Central Bank.** Luxembourg and Ireland have fairly substantial amounts of capital parked with the ECB, so they have to chip in heavily to the rescue.

These skewed numbers could add to the simmering resentments inside the euro zone. "Popular discontent might soon become broad as voters realize that as individuals they are contributing more than the average German," says Marco Annunziata, chief economist at UniCredit in London.

A quick test of this thesis in the streets of Dublin and Luxembourg produce some surprising results. The Irish, already subjected to draconian austerity measures by the Dublin government, seem more resigned to helping the profligate Greeks. "I think it's probably a consequence of being in Europe—we got all the benefits in the past, now we have to pay," says Liam Thompson, 45, an accountant. "It's a necessary evil."

In contrast, some citizens of the fairy-tale-like Luxembourg (above), the wealthiest economy in Europe after Lichtenstein, are plenty angry. "We have to bleed for the others only because Luxembourg is among the richest countries," says Sacha Ludovicy, 29, a civil servant in Luxembourg. Adds bus driver Tom Paternoster, 31: "It makes you wonder whether the whole Europe thing is good. We may just as well build a wall around ourselves."

—Jeffrey Donovan, Stephanie Bodoni, and Louisa Fahy

The bottom line *Discontent over the cost of the Greek bailout is spreading beyond Germany. European solidarity will be tested if the bill rises.*

Global Trade

China's Growth Could Lift Canada's Rates

▶ Booming demand from Asia heats up the Canadian economy

▶ "We have a great advantage over the U.S. and Europe"

It could be called the China Club, a special group of nations whose exports of raw materials increasingly fuel China's industrial machine. As China booms, the central banks of four members of this group—Australia, Brazil, Malaysia, and Peru—have already raised interest rates this year to tame brisk growth and inflation in their own economies.

Now investors are expecting Canada to raise rates sometime in June or July. Canada's position is in sharp contrast to the U.S., where the Federal Reserve probably won't raise rates until next year, or to Europe, mired as it is in its worst crisis in decades.

The **Bank of Canada** traditionally followed the Fed's lead in setting rates. Not this time. Demand from China, India, Korea, and other Asian economies has helped produce Canada's fastest growth in a decade.

The economies of Canada and the U.S. will grow 3.1 percent in 2010, faster than other G-7 countries, according to an International Monetary Fund forecast. Next year, however, U.S. growth will slow to 2.6 percent while Canada will continue to expand by 3.2 percent. Inflation in Canada, Bank of Canada policy makers said in an Apr. 22 report, will exceed the target rate of 2 percent this year.

Bank of Canada governor Mark J. Carney cited the momentum in emerging markets when he recently dropped a conditional pledge to leave his policy rate unchanged through June. China's sovereign-wealth fund agreed on May 13 to invest $769 million in an oil-sands venture with Calgary-based **Penn West Energy Trust.** Vancouver-based **Teck Resources,** Canada's largest base-metals producer, reported on Apr. 20 that first-quarter profit more than tripled, to $854 million, as copper prices climbed on increasing demand from China.

Canada's exports to China rose 6.6 percent, to $10.5 billion last year.

OPPOSITE PAGE: JONATHAN FICKIES/BLOOMBERG; THIS PAGE: ROBERT HARDING /GETTY IMAGES

Infrastructure

Who's Building the Big Projects

India, ranked below Ivory Coast by the World Economic Forum for the quality of its infrastructure, plans to raise up to $1 trillion in public and private funds to build ports, roads, and bridges. The news comes as India nears completion of its ultramodern Delhi Metro Rail. Currently, says Scott Lewis, head researcher at *Engineering News-Record*, the Mideast and East Asia lead the world in big projects, including highways, new cities, and water systems. Here are some of the largest, according to data from *Engineering News-Record* and reporting by Bloomberg. —*Caroline Winter*



South Valley Development Project

Egypt

Timeline
1997-2017

Estimated cost
$90 billion

To ease Egypt's population density—most people live on 5 percent of the land—the project's huge pumping stations will drive water from the Nile into the desert to create 2,300 square miles of arable land.



South-to-North Water Diversion Project

China

Timeline
2002-2050

Estimated cost
$62 billion

Expected to cost more than twice as much as the giant Three Gorges Dam, the project will supply more than 11 trillion gallons of water annually to China's parched north. It will relocate at least 300,000 people.



International Space Station

Space

Timeline
1993-2011

Estimated cost
$60 billion

Conceived in the 1980s and nearing completion, the ISS orbits Earth to collect weather data and aid experiments in biology, astronomy, and more. The U.S. share so far: $31 billion, says NASA.



Second Avenue Subway

New York City

Timeline
2007-2016

Estimated cost
$16.8 billion

This two-track line will run along Second Avenue from 125th Street to the Financial District in Lower Manhattan. (Work on the project originally began in the '60s but was suspended in the '70s.)



New Orleans Storm Protection System

New Orleans

Timeline
2005-2011

Estimated cost
$14.4 billion

The system will include levees, flood barriers, pump stations, and other infrastructure that should protect the city from another hurricane like Katrina.



Delhi Metro Rail

India

Timeline
1998-2010

Estimated cost
$6.5 billion

India's new 118-mile rapid transit system is on track to be completed this fall—on schedule and within budget.



Songdo Intl. Business District

South Korea



Timeline
2004-2015

Estimated cost
$35 billion

Built on 1,500 acres reclaimed from the Yellow Sea in Incheon, the planned city will include residential, commercial, civic, and cultural developments, a 100-acre park, and South Korea's tallest building.



Golden Quadrilateral

India



Timeline
2001-2012

Estimated cost
$6 billion

One of India's biggest projects will widen and pave more than 3,625 miles of roadways and build a network of multilane highways connecting New Delhi, Calcutta, Chennai, and Mumbai.

CLOCKWISE FROM TOP LEFT: YVES GELLIE/CORBIS; IMAGINECHINA/AP PHOTO; NASA; SONGDO IBD; TYLER HICKS/THE NEW YORK TIMES/REDUX; K ASIF/INDIA TODAY/GETTY IMAGES; ROBYN BECK/AFP/GETTY IMAGES; MARCUS SANTOS/NEW YORK POST/SPLASH NEWS

China has replaced Japan as Canada's third-largest export destination after the U.S. and U.K. "We have a great advantage over Britain, the U.S., and most countries in Europe," says Serge Coulombe, professor of economics at the University of Ottawa.

A rate hike looks certain, but the timing may depend on the turmoil in Europe. Carney "will still want to raise interest rates but needs at least a window of calm in equity and commodity markets to do that," says Avery Shenfeld, chief economist at CIBC World Markets in Toronto. While he predicts a June 1 move, "further downside would put the Bank of Canada in a position where it will be safer to wait until July." —*Greg Quinn*

The bottom line *Asian demand for Canada's raw materials should compel Canada's central bank to move more quickly than the Fed in hiking rates.*

Bailouts

What Athens Can Learn from Ankara

- Turks were worse off than Greeks —and the IMF cure worked
- "Confidence is the key. Once it's secured, the rest becomes easy"

In their centuries-old rivalry, Greece has viewed Turkey as occupier, religious rival, and strategic threat. Financial adviser wasn't on the list.

Yet the Greeks have recently received visits from Turkish Prime Minister Recep Tayyip Erdogan and Finance Minister Ali Babacan, who have valuable lessons to impart to the government of Prime Minister George Papandreou. Erdogan and Babacan came to power just after Turkey's economy was flattened by a banking crisis in 2001. Amazingly, the pair cleaned up the mess they inherited. "Turkey's done a lot on sharply managing its deficit," says Gavin Redknap, an emerging-markets strategist at Nikko Asset Management in London. "In Greece the politicians have been willing to throw money at any problem."

In the crisis of 2001, Turkey went through the latest in a series of financial convulsions. It was desperate for a way out of the mess and willing to take the bitter medicine proffered by the International Monetary Fund, which lent the country $45 billion.

Once Turkey had a mandate to tackle the causes of the crisis, the Erdogan government moved fast to carry out a plan that the IMF had drawn up with the outgoing administration. The agreement called for capping government salaries, raising taxes, curbing investment spending, and selling state assets.

Erdogan and Babacan used the IMF's tough regimen as an excuse for doing things that previous Turkish governments had avoided for decades. (Papandreou can blame the IMF, too, as long as he gets the job done.) The Erdogan government stepped up tax collection from companies and individuals who had underreported income for years. That's another similarity with Greece: Like the Turks, the Greeks have their own tax-resistant underground economy to deal with. The Turkish government also largely got out of the business of business, raising $30 billion by selling off state companies. The Greeks have a number of state companies as well.

In 2001, Turkey posted a budget deficit dwarfing Greece's in 2009. The Turkish authorities even failed to collect enough taxes to cover interest payments on the national debt. Today Turkey's debt, which approached 80 percent of gross domestic product in 2001, is down to 46 percent of GDP, compared with 115 percent for Greece.

What's surprising about Turkey's rebound is its speed. By 2005, Turkey's budget was almost in surplus. It turns out the first steps in tackling the emergency were the hardest. Finance Minister Babacan recently told an Athenian audience that "it was very difficult cutting expenses, trying to increase tax collections." He added: "Confidence is the key. Once it's secured, the rest becomes really easy."

The Greeks cannot replicate all of the Turks' success. Turkey's lira fell 54 percent against the dollar in 2001, which spurred exports and helped revive growth. Greece's adoption of the euro deprives it of such a strategy, while today's global economic weakness makes it hard to match Turkey's swift bounceback. "High GDP growth [for Greece] will be acutely difficult," notes Tim Ash, an economist at Royal Bank of Scotland. Ash thinks Greece needs to restructure its debt to relaunch its economy.

Global Economics

The Turks in 2001 faced a similar choice—to default or not. They didn't. "It was the right decision," says Simon Quijano-Evans, head of emerging-market research at Credit Agricole Chevreux in Vienna. "Now Turkey [is] one of the most credible countries in the Europe region in fiscal terms." There's no reason why Greece can't follow a similar path, he adds.
—Ben Holland

The bottom line *The Turkish experience proves that financially stricken countries can rebound. Confidence is essential, as is national unity.*

Currencies

War Jitters, Deflation—The Yen Still Rises

▸ Japan's currency holds steady despite a possible war next door

▸ The yen stays strong as the won takes a hit



DATA: BLOOMBERG
*PERCENTAGE CHANGE IN DOLLAR VALUE OF CURRENCY

Japan is again suffering from deflation. Prime Minister Yukio Hatoyama's ability to spur the economy is sharply constrained by record public debt exceeding 882.9 trillion yen ($9.78 trillion). It has the lowest interest rates of any developed nation in the world. Worst of all, North Korea has been accused of torpedoing a South Korean naval vessel, and it has cut off all relations with the South. After South Korea, Japan is tops on Pyongyang's enemies list: North Korea has in the past launched missiles over the Japanese archipelago. If shooting were to start, Japan likely would be involved.

Yet Japan's currency is not weakening as the economic and diplomatic uncertainties mount. The yen has actually strengthened against the dollar by more than 4 percent in the last month. It has risen 11.5 percent vs. the euro and 14 percent when compared with Australia's dollar. The South Korean won has dropped more than 10 percent against the greenback in the same period.

The yen's serenity in this turbulent sea stems from a number of factors. One is that the Japanese, unlike the South Koreans, have just enough physical and emotional distance to give them perspective on the crisis. "The fact that the yen [has] stood firm suggests people don't really think that this time political tensions will turn into a war," says Daisaku Ueno, president in Tokyo of Gaitame.Com Research Institute and widely regarded as Japan's best foreign-exchange analyst. It helps that foreigners hold only a small share of Japan's outstanding government bonds. Outsiders would find it hard to trigger a run on Japanese debt, which would damage the yen as well. Japanese savers, meanwhile, stubbornly hold on to their bonds.

With the fear of conflict discounted, the yen can benefit from a quirk in the markets. Because it has such low rates, traders and investors typically take out loans in Japan and exchange the proceeds for higher-yielding bonds from nations such as Australia, New Zealand, and Brazil. In times of global economic turmoil, like now, traders reverse these bets. As a result, money flows back into Japan as the loans are paid off, triggering a rise in the yen. This reversal of the so-called carry trade has a much bigger impact on the currency than war jitters from across the Sea of Japan.

The final element supporting the yen is that Japan still records huge trade surpluses with the U.S.—more than $28 billion in 2009. The country's deflationary domestic economy is weak, but the Japanese export machine beats anything a weakened America or Europe has to offer, with the possible exception of Germany. Yen strength is "absolutely not" a reflection of Japan's attractiveness, says Nicholas Smith, director of equity research at MF Global FXA Securities. "The yen is strong because the U.S. and Europe are in the tank." That strength may still be sapped if the Korean crisis lurches out of control. Right now, investors are betting otherwise.
—Yasuhiko Seki

The bottom line *War jitters in Korea aren't pulling down the yen. Other factors like the turmoil in Europe and the carry trade affect the yen much more.*

Tom Keene's EconoChat

Tom talks with Wellesley College Professor **Karl Case**, who helped develop the S&P/Case-Shiller Home Price Index

How fragile is our housing economy right now? How soft is soft?
I think it's fragile. The stuff we know is that housing starts are going nowhere. We're not getting any boost to the economy from that, and that's always been the engine that drags us out of these recessions. It looks like a bottom. It looks like there's the beginning of a recovery in place in house prices, and you can see the volume beginning to pick up. But there's a lot of inventory out there, and a lot depends on psychology. It takes guts to buy a house, and particularly in a bad economic environment, which we're back into.

Things were looking better last fall. What happened?
Well, the government's housing tax credit caused a lot of activity in October, November. We stopped hemorrhaging. And housing prices are down 30 percent nationally [from their peak]. That's bringing people back. [Yet] we're in this big downwardly sticky thing. If you look at the total number of houses that people would like to sell, it's a very large number. But owners won't sell at any price—they're holding out. The stock market doesn't help.

Should we focus on the optimism that comes from comparing home prices year-over-year, or should we look at the 90-day moving average?
Well, I like the 90-day moving average. It's up, but very modestly. The housing market is basically flat. It's waiting for something to happen. Ⓑ



Keene hosts Bloomberg Surveillance, 7-10 a.m., *1130AM in New York, XM129, Sirius 130.*

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EXECUTIVE EDUCATION

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Why Wal-Mart Wants to Take the Driver's Seat



Most suppliers can't match Wal-Mart's distribution muscle

GEORGE FREY/EPA/CORBIS

▶ **The retail giant wants to grab control of deliveries from manufacturers**

▶ **Suppliers' shipping costs "more than likely will be passed on to other retailers"**

Wal-Mart Stores, the world's largest retailer, has become famous–and at times infamous–for the power it wields over its suppliers. With its $408 billion in sales for the fiscal year ended Jan. 31, the retailer has plenty of clout to persuade makers of goods sold in its big-box stores to create environmentally friendly packaging and exclusive product sizes, and to participate in joint advertising promotions.

Now, Wal-Mart wants to be their chauffeur as well. The retailer aims to take over U.S. transportation services from suppliers in an effort to reduce the cost of hauling goods. Wal-Mart is contacting all manufacturers that provide products to its more than 4,000 U.S. stores and Sam's Club membership warehouse clubs, says Kelly Abney, Wal-Mart's vice-president of corporate transportation.

The goal: to handle suppliers' deliveries in instances where Wal-Mart can do the same job for less, then use those savings to reduce prices in stores, Abney says. Wal-Mart believes it has the scale to allow it to ship everything from dog food to lawn chairs more efficiently than the companies that produce the goods. "It has allowed our suppliers to focus on what they do best, manufacturing products for us," he says. "With lower costs usually comes increased sales."

Manufacturers would compensate Wal-Mart by giving the retailer lower wholesale prices for the goods it transports. Wal-Mart isn't saying how much it hopes to save. However, in a slim-margin business such as retailing, even small efficiencies can



Geithner's mission to China page 26 ▶

help the bottom line; in 2009, Wal-Mart trimmed expenses by almost $200 million by packing and scheduling its U.S. truck fleet more efficiently, according to spokesman Lorenzo Lopez.

Until now, suppliers made most deliveries to Wal-Mart's distribution centers. The retailer then used its fleet of 6,500 trucks and 55,000 trailers to ferry goods between the regional centers and individual stores. Under the new program Wal-Mart will increase its use of contractors, as well as its own vehicles, to pick up products directly from manufacturers' facilities.

That will allow Wal-Mart to carry more per truck and improve on-time delivery rates, says Leon Nicholas, a director at consulting firm Kantar Retail. Wal-Mart also would have more sway in negotiating fuel prices, thanks to its larger purchasing volume, he says.

The price cuts Wal-Mart is seeking are twice as much as the cost of transporting goods in some cases, say officials from two suppliers. In two instances, Wal-Mart asked for a 6 percent reduction in the price it pays for products based on its own cost calculation, while suppliers estimated the actual expense was equal to about 3 percent, the people say.

"There may be a disconnect when we walk into the room on what that cost might be," Wal-Mart's Abney says. "But we work collaboratively. As soon as a supplier shares the data, almost always those differences are quickly resolved."

Abney says Wal-Mart has thousands of suppliers and he has taken part in talks with more than 100. Some manufacturers have already shifted their deliveries and associated costs to Wal-Mart, he says.

One side effect of the Wal-Mart plan is that consumer-product manufacturers may face increased transportation costs on deliveries to other retailers as they lose economies of scale on their own delivery fleets, says Randy Huffman, a former Wal-Mart executive who now runs GBD 360, a Bentonville (Ark.) consulting firm that works with suppliers.

"That aligns with Wal-Mart's taking cost out of the supply chain for their benefit and not their competitors," he said. "Suppliers are going to have to apply that increased freight cost somewhere, so it's more than likely it will be passed onto other retailers."

Bentonville-based Wal-Mart is eager to reduce expenses after announcing on May 18 that sales at its U.S. stores open at least a year fell for a fourth straight quarter. Mike Duke, who took over as chief executive officer last year, pledged in October that costs would rise slower than sales. Since then, Wal-Mart has sharpened its focus on transportation expenses, escalating talks to take over trucking from suppliers this year, Abney says.

The retailer also has sought to offer goods like cereal and laundry detergent for less to lure shoppers back to stores; lowering transport costs provides room to do that. The strategy is part of what Wal-Mart calls its "productivity loop"—efficiency reflected in lower bills for shoppers at the cash register.

As for suppliers, they may have to go along with the plan even if their other remaining transport expenses rise because Wal-Mart is so big, says Vic Gallese, an independent retail consultant based in Fort Worth. "The vendors might say, 'My other overhead costs will rise,'" said Gallese, who has spent 25 years in the retailing industry. "And Wal-Mart will say, 'That's your problem.'"
—*Chris Burritt, Carol Wolf, and Matthew Boyle*

The bottom line *By attempting to take over the transportation from its suppliers, Wal-Mart hopes to achieve efficiencies to cut its own prices.*

$3.9

MILLION

Estimated median cash pay for Harvard MBA grads over 20 years

PAYSCALE

Heavy Industry

China's Elevators: Built for Serious Speed

- ▶ **Competition for installations mounts as skyscrapers sprout**
- ▶ **"If you have more tall buildings, you're going to need more lifts"**

Frank Lloyd Wright predicted U.S. suburban sprawl when he said the shape of modern cities would be decided by the winner of a race between the car and the elevator. "Anyone who bets on the elevator is crazy," he said.

China may prove him wrong. Some 350 million Chinese—more than today's entire U.S. population—will move to China's cities in the next decade and half, according to McKinsey, and government measures to limit sprawl and protect farmland mean developers have to build up rather than out. McKinsey estimates that as many as 50,000 skyscrapers will be built in China over the next 15 years, the equivalent of 10 Manhattans.

The prospect of that building bonanza has manufacturers racing for a piece of an $11.7 billion annual Chinese elevator market that researcher Freedonia Group predicts will more than double within eight years. While **Otis Elevator** leads with a 23 percent share, lesser-known elevator makers hope to make names for themselves by breaking speed records or winning trophy contracts in the world's tallest structures.

"If you have more tall buildings, you're going to need more lifts," says Philip Oldfield, a researcher at the Chicago-based Council on Tall Buildings & Urban Habitat. "It's that simple."

Hitachi in April finished building a $66 million, 50-story testing tower. The company will use it to develop elevators that can break the speed record, currently held by **Toshiba**. Two days after the tower opened, **Hyundai Elevator** vowed to take the title by midyear.

Hitachi and Hyundai are racing to be first with elevators that can climb at an ear-popping 40 mph, roughly the vertical speed of a Boeing 777. The one-upmanship extends even to the testing towers, where the two are dueling over which has the world's tallest. Hitachi won by tacking on a 33-foot lightning rod.

66
million dollars
The cost of Hitachi's new elevator-testing tower

57
Number of elevators in Dubai's Burj Khalifa, a 128-story tower double the height of the Empire State Building

38
mph
Speed of the world's two fastest elevators, manufactured by Toshiba for the Taipei 101 skyscraper

23
%
Market share in China of United Technologies' Otis Elevator unit; Otis' worldwide share is 20%

11.7
billion dollars
Size of China's elevator market

1
first
elevator was invented by Elisha Otis in 1852

"It's a very expensive sideshow, but they want to get into the big boys' playground," says James Fortune, a veteran elevator consultant who has advised architects on some of the world's tallest buildings, including the current record holder, Dubai's Burj Khalifa. "You don't hear the big guys bragging about the world's fastest elevators."

The world's biggest elevator maker is Otis, which supplied the 57 lifts for the 128-story Burj Khalifa. Its share of the world market slipped to 20 percent in 2008 from 26 percent four years earlier, according to Freedonia. Otis, a subsidiary of **United Technologies**, had sales of $11.7 billion last year, 50 percent more than the elevator sales of its closest rival, Switzerland's **Schindler Holding**.

To grab share in China, Otis will soon start construction on a fifth Chinese factory. The plant in the inland city of Chongqing is meant to capitalize on a government push to help less-developed areas catch up with coastal cities like Shanghai and Guangzhou. The government's "go-west policy" is one reason about half of the 450,000 elevators installed this year worldwide will go up in Chinese buildings, according to Jeff Pulling, Otis' head of high-rise operations.

Chinese manufacturers are also ramping up. Shenyang Brilliant Elevator, which has become one of the country's biggest domestic lift makers since opening in 2002, will move in July to a 222-acre elevator factory in Shenyang that vice general manager George Tsong says will be the world's largest. The new plant will crank out about 50,000 elevators a year.

Marquee projects make great advertising, says Shinji Sasaki, general manager for overseas marketing at **Mitsubishi Electric**'s elevator unit. Mitsubishi supplied 61 elevators for the Jin Mao Tower, a skyscraper in Shanghai's financial district that was China's tallest building from 1999 until 2008. "We take clients there and have them see for themselves," Sasaki says. "We've landed a lot of sales from that."

That marketing effect is what Toshiba was looking for when it cut an "irresistible" deal for the owners of the Taipei 101 tower, says C.P. Wang, principal architect of C.Y. Lee & Partners, which designed it. The world's tallest until Burj Khalifa overtook it this year, the Taipei 101 makes use of 50 elevators, including two express lifts that travel at a world-record 38 mph. "They wanted a building that showcased their abilities, so they threw in the marketing costs," says Wang. "They gave the owner a very good price." —*Jason Clenfield*

The bottom line *As China builds up, not out, demand will swell for fast elevators.*

Energy

BP Faces Extra Obstacles After Spill

- ▶ Past safety lapses heighten skepticism of the oil giant
- ▶ "Would you want to be responsible for giving BP a lease?"

Any energy company responsible for something like the disaster in the Gulf of Mexico would face an uncertain future. **BP** faces two special challenges its rivals would not: Before the spill, it already had a reputation for lax safety practices. And more than any other major producer, it is committed to operating in the gulf.

Those factors will complicate any campaign the British oil titan mounts to polish its stained image and maintain its dominance in offshore drilling in the waters south of the U.S.

Since the early 1990s, the company has staked much of its future on a risky deepwater strategy. It has amassed some 500 leases in the gulf through U.S. government auctions—more than any other company. It leads in gulf production, with 450,000 barrels a day of oil and natural gas converted to oil units, accounting for about 11% of BP's output and more of its profits.

Gulf oil earns BP about $20 per barrel, estimates Fadel Gheit, an analyst at Oppenheimer. That's roughly three times what it makes in Russia, another stronghold. The U.S., where BP has about a quarter of its total oil and gas production, represented one-third of its profits in the first quarter.

At the very least, BP will suffer a slowdown in the gulf because of investigations, strained resources, and permit delays, which could translate into a decline in its overall growth. "We have altered our drilling plans now and for some time



BP CEO Tony Hayward needs the gulf's more profitable oil

OPPOSITE PAGE: JOSE LUIS MAGANA/REUTERS; THIS PAGE: PABLO MARTINEZ MONSIVAIS/AP PHOTO

Companies&Industries

in the future," a BP spokesperson said. A BP partner, **ConocoPhillips**, has said that development of Tiber, a huge discovery made by BP in the gulf last year, would be set back.

Exacerbating the inevitable obstacles BP faces in the gulf is a history of safety lapses. In March 2005, explosions and fires at the BP refinery in Texas City killed 15 people and injured 180 others. Government investigators attributed the blast to deficiencies at all levels of the company. The Occupational Safety & Health Administration fined BP a record $21 million and then hit it with a new record penalty of $84 million last year after determining that the company hadn't fixed certain violations.

Another accident at the same refinery in January 2008 resulted in a worker death now under investigation by the U.S. Chemical Safety Board. Normally one fatality might not trigger a full-dress probe, says the panel's chairman, John Bresland. "With BP we would certainly give it a closer look," he adds.

The question BP faces is how badly its reputation for mishaps will damage the exploration and production business that brought in nearly all of its $6 billion in profits in the first quarter of 2010. A leading global position in oil and gas could be at risk if governments in the U.S. and elsewhere begin to shy away, says Amy Myers Jaffe, an energy scholar at the Baker Institute for Public Policy in Houston. "If you were a politician, would you want to be responsible for giving BP a lease?" —*Stanley Reed, Jessica Resnick-Ault, and Brian Swint*

The bottom line *Having placed a huge bet on perilous deepwater drilling in the Gulf of Mexico, BP faces risks its rivals might not.*

Quoted

"I'm devastated."
—Bono, U2 singer and activist, on the group's cancellation of 17 dates of its U2 360 tour, sponsored by BlackBerry, due to his back surgery



Automobiles

Kia Turns to Design in a Bid to Move Upmarket

▶ The Korean carmaker hopes to sell its new Optima on looks, not price

▶ "It's a car that people will simply not expect from Kia"

Kia Motors has an advantage over many auto companies. Its Optima sedan undercuts the list price of **Toyota Motor**'s Camry, one of America's most popular cars, by $1,600. Yet the longtime maker of economy rides is hellbent on selling the revamped Korean car on its looks instead.

The new Optima, with a coupe-like profile, cockpit-style instrument panel, and "tiger-nose" grille, completes the overhaul of Kia's sedan lineup by Peter Schreyer, the carmaker's Frankfurt-based head of design. The model, which went on sale in South Korea as the K5 this month and will be introduced globally later this year, competes against the Camry and **Honda Motor**'s Accord. "It's a car that people will simply not expect from Kia," said Schreyer. "And that's exactly what we set out to do."

Kia lured the 56-year-old German in 2006 from his design post at **Volkswagen**, where he worked on the iconic Audi TT sports car. His mission: change the perception of Kia from a company known mainly for cheap cars to one known for visual appeal. Since his arrival, rising sales have fueled record profits at the Seoul-based carmaker.

"The new Optima will be the key product that makes Kia a true global player," said Cho Soo Hong, a Seoul-based analyst at Hyundai Securities, which isn't related to Kia affiliate **Hyundai Motor**. "This model completes the reinventing of the brand, which wasn't historically known for good sedans."

Retail sales at Kia in the first four months of this year jumped 44 percent from a year earlier. That helped the carmaker boost first-quarter profit fourfold to 398.6 billion won ($328 million). Kia's shares, traded on the Korea Stock Exchange, have soared 45 percent since Jan. 1, after tripling in 2009, when it posted a record full-year profit of $1.19 billion on a 20 percent surge in retail sales.



Eye candy: Kia's Optima with designer Peter Schreyer

Eventually, Schreyer hopes Kia's design changes will allow it to charge more for its cars, boosting profitability. "Absolutely, it's very important to increase the value of the brand and the value of our cars by design," he says. "This is why we're trying so hard."

The picture was less promising four years ago, when then-President Chung Eui Sun, now vice-chairman of Hyundai Motor, was under pressure to turn the carmaker around. With aging models and a strengthening won, Kia saw profit tumble 94 percent in 2006 and its stock lose 49 percent of its value.

Chung, the son of Hyundai Motor Chairman Chung Mong Koo, says he picked Schreyer to make Kia "a design-choice brand without high pricing." Schreyer studied transportation design at the Royal College of Art in London and joined Audi in 1980. Besides the TT, he had overseen work at VW on the new Beetle, introduced in 1998.

At the time, Schreyer saw Kia as "just another Asian carmaker" without much character, he said. Still, he quickly accepted the offer to lead the company's design centers in South Korea, Germany, and California. "It's a world I'd never have seen if I'd stayed where I was," Schreyer said.



His team introduced the tiger-nose for Kia models in 2007. It's now featured on almost all its cars including the new Optima, the revamped Sorento sport-utility vehicle, the Soul crossover, and the Forte compact.

Schreyer compares the new Optima to an "Italian suit," citing its "simplistic elegance." Kia says it already has received about 14,000 orders in Korea for the redesigned sedan, which premiered at the New York International Auto Show on Apr. 1. Projected success for the model abroad will help the automaker meet a target of boosting global sales 27 percent, to 1.94 million vehicles this year.

Eric Noble, president of CarLab, an automotive consulting company in Orange, Calif., says Schreyer has taken Kia's former "fairly undistinguished" models and transformed the company into an industry leader in design.

It's still unclear whether Kia can convince customers that sharp design is the main reason to buy its cars. In Europe, a seven-year warranty introduced for all Kia models this year is a big draw for the Korean brand, said Johan Bylund, sales manager at Svenska Bil in Stockholm, one of Sweden's biggest auto retailers.

Maria Eriksson, a 34-year-old physical therapist in Stockholm, said she decided to buy a Kia Cee'd compact wagon in early May because of the unusually long warranty and its "very favorable price." *—Seonjin Cha*

The bottom line *Long known as a maker of low-priced utilitarian cars, Kia hopes its focus on design will allow it eventually to command higher prices.*

Undercutting the Competition



BONO: LEON/RETNA LTD/CORBIS; SCHREYER: GABY GERSTER/LAIF/REDUX

Pharmaceuticals

Karo Bio's Prescription: Cheaper Drug Approval

▸ A Swedish company seeks a lower-cost review for its cholesterol drug

▸ Crafting a testing regimen "without costing a half billion dollars"

Karo Bio, a tiny Swedish biotech company with no products on the market, has a big problem. Its experimental cholesterol-lowering pill is a potential blockbuster. But only if it can raise the $500 million needed to bankroll up to five years of large-scale testing normally required for widely used drugs that combat disease in unfamiliar ways.

Karo's prescription for its predicament is as novel as its compound: enlist one of the world's premier cardiologists to help convince the Food & Drug Administration that such expansive—and expensive—testing is not needed.

The company has retained Steven Nissen, the head of cardiology at the Cleveland Clinic and a frequent adviser to the FDA on drug safety. Nissen says there is a need for new types of cholesterol pills, among the world's most widely used drugs, and he's endorsing a clinical trial that could cut the usual approval time by half. Nissen and Karo must persuade the FDA to go along—and convince a big drugmaker to help pay for trials tiny Karo can't afford alone.

"What we are trying to do is look for a strategy that allows the company to move forward in a deliberative fashion to develop the data they need without costing half a billion dollars," Nissen said in a telephone interview. "That requires innovative thinking."

The potential payoff is huge. Alexander Lindstrom, an analyst at ABG Sundal Collier in Stockholm, forecasts that sales of Karo's drug, eprotirome, could reach $1.3 billion a year. **Pfizer**'s Lipitor, the largest cholesterol drug, had sales of $11.4 billion last year. It will lose patent protection in 2011.

Eprotirome is a version of a thyroid hormone that is engineered to work only in the liver, where it helps clear cholesterol from the body. By contrast, Lipitor blocks a liver enzyme needed to produce cholesterol.

Quoted

"Nothing in life and nothing that we do is risk-free."
—Ken Salazar, U.S. Interior Secretary on the dangers of deepwater energy exploration



Patients given eprotirome in addition to Lipitor or **Merck**'s Zocor had 32 percent lower levels of so-called bad LDL cholesterol than patients given the marketed medicines alone in a trial. Two other studies testing the drug alone and with alternative cholesterol treatments also posted positive results. Now a final round of studies is needed to confirm the drug's benefits.

"This is...the first new targeted compound within this area for many, many years," says Jens Kristensen, Karo's chief medical officer. The company originally planned to begin the final studies of eprotirome last year, and is delaying the start as it irons out study details with regulators. Kristensen declined to specify how much the research may cost, saying the company can fund smaller studies alone.

Since the Karo drug works with the liver in a different way than current medications and could be taken over many years, regulators normally require a more stringent review. Explains Robert J. Temple, director of the FDA's office of drug evaluation: "When you are using a drug chronically in fundamentally healthy people to prevent disease, how much assurance do you need? We certainly think about that."



Cardiologist Steven Nissen of the Cleveland Clinic is aiding Karo Bio

Trying to market any heart drug is risky. Pfizer spent almost $1 billion and 13 years of research on torcetrapib, an intended Lipitor successor, before scrapping it in 2006. Nissen and Karo are proposing a shortened research path for eprotirome, one based on requirements the FDA imposed a year ago on diabetes drugs. Those medicines were originally approved on the basis of their ability to control blood sugar. But after **GlaxoSmithKline**'s Avandia diabetes drug in 2007 was linked by Nissen to an increase in heart attacks in patients, the FDA required companies to also show that their diabetes products don't raise significant heart risks. That has pushed some health advocates to press the FDA for wider testing of possible side effects of other new medicines intended for long-term use.

Nissen says his plan for eprotirome's study would include more patients than the several thousand in the initial research for Lipitor and products like it, while taking less time and money than Pfizer's torcetrapib, which had a trial involving about 15,000 people. The goal is to show the Karo compound cuts both cholesterol and heart attacks without serious side effects, while pushing eprotirome through the approval process in less than three years.

If regulators clear Karo's limited scope for research, it will still cost $300 million or more, figures Erik Hultgard, an analyst at Handelsbanken Capital Markets in Stockholm. That's why Karo, with assets of only $35 million at the end of 2009, needs help from a deep-pocketed drug company.

More than 81 million Americans, or one in three adults nationwide, have some form of cardiovascular disease, and 831,300 die from it every year, according to the American Heart Assn. Such numbers underscore the potential for eprotirome, said Lindstrom.

But Handelsbanken's Hultgard says generic versions of Lipitor may flood the market before Nissen's drug trials are completed. That could discourage investment from large pharma companies in new brand-name drugs in the niche, he said. "With the market being highly generic, I think the willingness to pay for these types of drugs will come down," Hultgard said.

Also, Karo must deal with the uneasiness many health advocates have with attempts to fast-track drug approvals. Rory Collins, co-director of the University of Oxford's Clinical Trial Service Unit, which studies causes and treatment of chronic diseases, says studies of the kind Nissen proposes can't rule out all significant risk. "We know hormones have other effects," says Collins. "I think one would be a little bit more wary and would want to have large-scale trials."

—*Michelle Fay Cortez*

The bottom line *Karo Bio has recruited a renowned drug-safety expert to help develop a fast-track plan for approving its new drug.*

Telecom

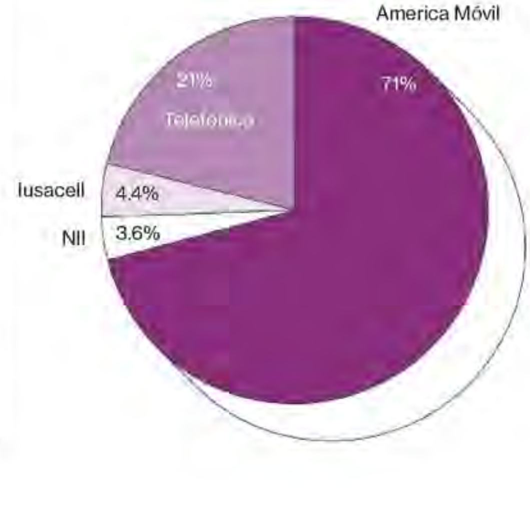
Mexico's Big Cellular Problem: Carlos Slim

- **The billionaire's wireless unit stays on top after latest spectrum auction**
- **"It's a disappointment" for Mexico that many foreign rivals stayed away**

Mexico is dead last among Latin America's five largest economies in cell phone use per capita. The problem, government officials say, is billionaire Carlos Slim. His company, **America Móvil**, controls 71 percent of Mexican cellular traffic. For years, the government and mobile industry have tried to reduce that dominance. Yet when the results came in from a May 25 auction of new radio spectrum intended to break open the market,

Carlos Slim's Lock on Wireless

Through his America Móvil, Mexico's richest man is a force in cellular



22

it looked like Slim had further tightened his grip.

Slim's spectrum gains in the auction moves his company closer to offering 4G service. If he does, America Móvil's network would move data up to four times faster than the 3G service that an investment group including Spain's **Telefónica, NII Holdings**, and Mexican broadcaster **Televisa** hope to launch with the spectrum they won in the bidding.

Mexican regulators had hoped the added spectrum capacity would bolster Slim's rivals. One goal: To raise the 77 percent of Mexicans who have a wireless device closer to the 90 percent average of big Latin American nations. However, some foreign investors declined to enter the bidding. "What worried [potential competitors] the most was the regulation in Mexico," said Gonzalo Martínez Pous, a member of the country's Federal Telecommunications Commission.

President Felipe Calderón's government had invited foreign bidders. **Deutsche Telekom**, **China Mobile**, and Mumbai's **Reliance Communications** declined to participate. "It's a disappointment for the government," says Christopher King, an analyst at Stifel Nicolaus.

Potential competitors voiced concerns about high payments to connect to Slim's mobile network and unclear rules on how companies could share infrastructure, said Martínez Pous.

Mexicans pay extra fees to call people on different cell networks. That makes America Móvil the best option for many Mexicans because it is by far the biggest. The government has tried to force Slim's company to levy lower interconnection fees. America Móvil sued to block the plan; the case is now tied up in court. In a statement, Móvil said Mexico is very competitive, that the company leads the market because of its superior coverage, and interconnection fees are negotiated between companies.

The status quo is good news for Slim, who is worth an estimated $14.6 billion. Profit margins for wireless service in Mexico at his company are the highest among Latin America's seven largest countries and ranks fifth among carriers in 50 countries worldwide, reports Merrill Lynch. Ⓑ —*Crayton Harrison*

The bottom line *Cellular phone service is a profitable business in Mexico. But the expense of connecting to the existing networks discourages new entrants.*

OPPOSITE PAGE FROM TOP: STELIOS VARIAS/REUTERS; DAVID MAXWELL/THE NEW YORK TIMES/REDUX. THIS PAGE FROM TOP: DENIS DOYLE/BLOOMBERG; RAJESH NIRGUDE/AP PHOTO; NEWSCOM

In brief



Blowing the lid off a telecom dispute: Spain's Telefónica wants to take full control of Vivo

Telefónica
Neighbors Tussle Over a Brazilian Gem

Spain's Telefónica has raised the stakes in its four-year battle to gain full control of Vivo, the Brazilian mobile carrier it owns jointly with Portugal Telecom. On May 25, Telefónica threatened to launch a hostile takeover of Portugal Telecom if the latter does not accept a $7 billion offer for the remainder of Vivo. Portugal Telecom is loath to cash out of the joint venture, however. Vivo commands a 30 percent share of Brazil's 179 million wireless subscriptions and has been a major source of revenue growth for both of its owners.

Teva/Mylan
A Day in Court for Makers of Generics

On May 24 the U.S. Supreme Court signaled interest in hearing an appeal by makers of generic drugs seeking limits on patient lawsuits. The justices asked the Obama Administration whether to accept the appeal by Mylan and Teva Pharmaceutical Industries, which are fighting allegations that they provided inadequate safety warnings on metoclopramide, a drug used to treat stomach disorders. The drugmakers argue that a 2009 Supreme Court ruling permitting failure-to-warn suits against brand-name drugmakers should not apply to them because federal law requires generic drugs to have the same packaging as their brand-name counterparts. Lower courts have rejected that contention.



Reliance
Unleashing Fraternal Competition in India

India's estranged billionaire Ambani brothers announced on May 23 that they had torn up a noncompete agreement they drafted in 2005, the year the two divided the family empire. Mukesh Ambani (above right) kept petrochemical, oil, and gas units, along with the flagship company, Reliance Industries. Anil Ambani (above left) got newer businesses such as power, telecommunications, financial services and entertainment. While it was designed to keep the peace, the ban on competition has stoked tension between the world's richest siblings, ultimately landing them before India's top court. This latest move apparently aims at fostering healthier—if probably no less spirited—rivalry between the two men.

Hewlett-Packard
Beyond Big Blue In Servers

Hewlett-Packard overtook IBM to lock up the top spot in global server sales, according to a May 25 report by research firm Gartner. HP, the world's biggest maker of personal computers, logged $3.4 billion in sales in the first quarter, for a a 31.5 percent market share; IBM's share fell to 28.4 percent. HP is benefiting as corporate customers upgrade equipment after delaying purchases during the recession.

AIG
Bailing out Of Properties

AIG is weighing the sale of its stake in some 17,000 apartments purchased in a partnership with Morgan Properties. AIG and Morgan paid $1.9 billion for 86 apartment complexes in June 2007. Sources familiar with the talks say that Morgan may buy the majority of the insurer's stake but did not say what price AIG is seeking. Prices for U.S. apartments are rebounding but remain far below their 2007 peak. The proposed sale would help AIG to repay loans included in the U.S. government's $182 billion rescue.

Pabst Brewing
Adding the Ingredients For a Beer Deal

Woodbridge (Ill.)-based Pabst Brewing is close to lining up some $90 million in financing to facilitate a buyout by private-equity investor C. Dean Metropoulos. The owner of the Pabst Blue Ribbon and Old Milwaukee brands, which are brewed by third parties under license, hired Bank of America Merrill Lynch last year to find a bidder. If the deal goes through, Metropoulos, 61, will get a stable of 25 brands which together have less than 2 percent of the U.S. market.



Contents ▶ Washington takes note of the troubles in dairyland 24 ▶ The states most likely to default 28 ▶ On regs, it's heads, Wall Street wins, tails, Wall Street wins 28 ▶ Is Obama having his Katrina moment? 30 ▶ Charlie Rose talks to Syrian President Bashar al-Assad 31 ● Edited by Paula Dwyer



Geithner displayed a more relaxed side in China recently

NELSON CHING/BLOOMBERG

Can Geithner Pull the Right Strings in Beijing?

▶ **He's plugged in, even speaks some Mandarin, though that may not sway China on currency**

▶ **"I see no signs that Geithner has had the slightest effectiveness with the Chinese"**

When it comes to dealing with China, Timothy Geithner is one of the most culturally clued-in Treasury Secretaries in U.S. history. He studied at Chinese universities and speaks some Mandarin, and his ease with Chinese officialdom was evident during a three-day visit to Beijing that ended on May 25. Yet in pushing President Barack Obama's agenda, ranging from currency issues to gaining support for fresh sanctions on Iran, Geithner's China connection might not make any difference.

Geithner knows better than most that it pays to be patient when dealing with the mainland. When China's first Communist premier, Zhou Enlai, was asked to assess the importance of the French Revolution, he famously (perhaps apocryphally) quipped: "It's too early to say." Just a few weeks ago the U.S. goal of persuading China to revalue the yuan, allowing it to strengthen against the dollar, seemed within reach. Instead, the summit was dominated by more urgent discussions of Europe's debt crisis and tensions with North Korea.

Even so, Geithner said in an interview with Bloomberg Television that he is "as confident as I've ever been" that an agreement is possible. Kenneth Rogoff, a professor of economics at Harvard University and a former chief economist of the International Monetary Fund, says that optimism is justified. Before the European debt crisis reached critical mass, the Chinese "were on the fence" and "probably we could have talked them into" an agreement, says Rogoff. The deal was "derailed because the Chinese rightly were concerned that the markets are unstable."

Whether Geithner can close a deal on the Chinese currency, which for nearly two years has been pegged at a rate of 6.83 yuan to the dollar, remains to be seen. If he fails, it won't be for lack of inside knowledge about the Chinese. Although Geithner spent his childhood in Zimbabwe, India, and Thailand, China has special appeal for him. He holds bachelor's and master's degrees in East Asian studies. While an undergraduate at Dart-

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Google's latest launch: A trading floor 33 ▶



mouth College, he spent two 10-week stints studying Mandarin at Peking University and Beijing Normal University, where he was given a Chinese name, Gao Yiran, an echo of his American name that also carries the meaning elegant or graceful.

As he did when he made his first official visit to China in 2009, Geithner, 48, used this trip to showcase a more relaxed side of himself that he seldom, if ever, displays at home—that of a Chinese-proverb-quoting, basketball-playing former exchange student. He shed his dress shoes for a pair of **Nike** sneakers to play basketball with students at Renmin University High School in Beijing, and he was equally comfortable in some of his official dealings with Chinese leaders.

In his opening remarks, Geithner made the case that Europe's woes would have only a small effect on a global recovery led by the U.S., China, and emerging-market nations such as Brazil and India. Vice-Premier Wang Qishan, Geithner's counterpart and a longtime friend of the Treasury Secretary's father, countered that the debt crisis has triggered a chain reaction that put the global recovery at grave risk. The back-and-forth was a thinly veiled debate over whether it's safe for China to roll back crisis-fighting economic stimulus measures that include the yuan peg, along with a little friendly jostling.

"They seemed to have a very good relationship," one member of the 200-strong U.S. delegation, Federal Deposit Insurance Corp. Chairman Sheila Bair, said in an interview in Beijing. "Maybe a little competitive, but in a healthy, positive way."

Geithner's warm reception contrasts with the criticism he faces on a daily basis back home. In Washington, he is routinely called out for his support for the U.S. bank bailout and pragmatic approach to financial regulation. Geithner also has taken heat for postponing a mandatory report on foreign-exchange markets that some lawmakers say should brand China an illegal currency manipulator. Heading into June's Group of 20 meetings, Geithner can expect more pressure from Senator Charles Schumer (D-N.Y.) and others who call for a more confrontational approach to China. They argue the mainland should be threatened with sanctions unless it lets the yuan rise against the dollar.

"I see no signs that Geithner has had the slightest effectiveness with the Chinese," says Alan Tonelson, a research fellow at the U.S. Business & Industry Council. "The big test of the Administration's policy will be whether Congress is impressed with this dismal record."

Tonelson clearly isn't a fan. Geithner, however, appears to have plenty of them on the mainland, judging by his warm reception in China. Particularly flattering were the comments of Chinese television talk show host Chen Luyu, a Chinese version of Oprah Winfrey, who referred to the Treasury Secretary as one of the Obama Administration's best-looking officials.

Safe to say, Geithner's looks probably matter less with the Communist Party bosses who protect the country's strategic interests. Respect for Chinese traditions can go a long way, though. At the high-level talks, Geithner quoted a Chinese proverb, *feng yu tong zhou*. It means to stand together regardless of the situation and, in this context, signaled that Geithner was willing to let his Chinese friends take the long view—at least for a couple more months.
—Rebecca Christie

The bottom line *Beijing leaders won't budge on the yuan unless they deem it in their self-interest, though Geithner's China savvy definitely doesn't hurt.*

13

TRILLION
Total U.S. debt, as of May 26, was $12.996 trillion and is expected to top $13 trillion any day.

Agribusiness

Dairy Farmers Say They're Getting Milked

- **Market dominance and possible manipulation hit milk prices**
- **"Dean Foods has 70% of the market ... There's no competition"**

At Harold Howrigan's dairy farms in northern Vermont last year, the red ink flowed almost as fast as the milk. The dairyman lost nearly $100 per cow each month because the price for 100 pounds of milk fell to $11—well under the $18 cost of production. "It was bad. People had to borrow money just to make ends meet," says Howrigan. Prices have recovered some, though not enough to pay down the new debts, he says.

These are tough times for America's 60,000-odd dairy farms, thanks to a decade-long deflationary trend in prices and a particularly severe downturn last year. Industry sales fell 30 percent in 2009, to $24.1 billion, from the year-earlier period, according to the Agriculture Dept.

Congress, which spent $350 million on emergency dairy price supports last year, has taken notice. So has the Justice Dept. To assess the effect on prices, it is scrutinizing the biggest dairy cooperatives and food companies for possible anticompetitive conduct. Along with the USDA, Justice officials will hold a June 25 hearing in Madison, Wis., on dairy market concentration. Meanwhile, the Commodity Futures Trading Commission is reviewing complaints of price manipulation in the spot cash market for cheddar cheese, which also affects the price of milk.

Two big players, Dallas-based **Dean Foods** and the **Dairy Farmers of America**, a Kansas City (Mo.)-based cooperative, are the target of pending federal class actions (one filed in 2008, the other in January) in which they are accused of colluding to control market access and suppress milk prices. Dean Foods, which buys raw milk to bottle or to make cheese, cream, and other products, is the nation's largest processor. It is best known for brands like Garelick Farms, Land O'Lakes, and

PHOTOGRAPH BY AMANDA FRIEDMAN FOR BLOOMBERG BUSINESSWEEK



Declining milk prices hit Vermont dairy farmer Howrigan hard

PHOTOGRAPH BY ANDREW HETHERINGTON FOR BLOOMBERG BUSINESSWEEK

Meadow Gold. Dairy Farmers is a co-op of 18,000 members that transports milk to food companies. Yet it is more than just a distributor: The group also owns bottlers, processing plants, and retail brands including Borden Cheese, and is the exclusive supplier of milk to some of Dean's plants.

Rival dairy farmers say these two big players benefit from lower milk prices and use their market clout to keep them that way. "We have a nonfunctioning marketplace due to consolidation," says Joaquin Contente, a dairyman in Hanford, Calif., and president of the California Farmers Union. "In all the big metro areas, Dean Foods has 70 percent of the market share. There's no competition anymore."

Dairy Farmers says the allegations in the federal suits are without merit and that the interests of the co-op, which represents only 20% of U.S. milk volume, are aligned with its members. "We function to get the most out of their milk, and we're their true advocate," says John Wilson, a senior vice-president for marketing and industry affairs. Liliana Esposito, a spokeswoman for Dean Foods, said in an e-mail that the company is "confident an objective review of the facts in each case will reveal competition is alive and flourishing in the dairy industry."

Senator Bernie Sanders, an independent who represents Vermont, a big dairy state, has urged the Justice Dept. to investigate the antitrust allegations outlined in the two cases. Assistant Attorney General Christine Varney, head of the Justice Dept.'s Antitrust Div., said last fall that "we are very cognizant of the allegations at issue here."

$24 BILLION

U.S. dairy industry sales in 2009, a decline of 30 percent from 2008

On May 18, Sanders met with Rick Smith, chief executive officer of the Dairy Farmers co-op, to urge him to conduct his business in farmers' interest, not the interests of his company's processing facilities. "Of course there's a conflict," says Sanders. "You're a co-op and you're purchasing your product from farmers, but you make more money if the prices are low."

Regulators also have their eye on the Chicago Mercantile Exchange's spot market for cheddar cheese. This tiny market, where less than 1 percent of the cheddar supply is bought and sold, sets the price of most cheddar sold across the country and influences the federal milk price. (The federal government sets a minimum price that a bottler must pay farmers for milk using a formula tied to spot cheddar cheese prices on the Chicago Merc.) The Government Accountability Office in a 2007 report warned that the thinly traded market for cheddar was ripe for manipulation.

In 2008, the Dairy Farmers co-op and its former CEO and chief financial officer agreed to pay $12 million to settle accusations by the CFTC that they manipulated the price of cheese to boost the value of futures contracts they had bought. The co-op and the two officials, who retired before the CFTC case was filed, agreed to pay the fine without admitting or denying guilt. Chicago Merc spokeswoman Mary Haffenberg says the exchange has the regulations and surveillance systems needed to uphold the integrity of its markets.

Another concern is that with prices falling, dairies are trying to make up profit declines by increasing

State Budgets

Red Ink from Sea to Shining Sea

Europe has Greece. The U.S. has California, Illinois, Nevada, and other states in various stages of fiscal crisis. The likelihood of a state default appears remote. Still, investors are worried, judging by the credit-default swap market, where the cost of insuring state debt is going up. The numbers for each state below show the cost to investors to insure $10 million in debt. As of May 25, California leads the nation with a $272,400 tab for credit insurance on its debt. Here are the six most troubled states. —*Cristina Lindblad and Caroline Winter*

California

272.4



Republican Governor Arnold Schwarzenegger is seeking a new round of budget cuts to close a $19 billion gap for the year starting July 1. He has vowed not to raise taxes. State Democrats are opposed to dismantling a welfare program for families, and a plan to cut wages for state workers by 10% has unions up in arms.

Illinois

237.3



Legislators appeared on the verge of finalizing a budget on May 26. Most of the debate centered around whether the state should borrow $37 billion to make its annual contribution to the state pension system. Democratic Governor Pat Quinn failed in his quest to raise taxes, a move he says is critical to righting state finances.

Nevada

210.7



The budget Nevada's legislature approved in late February aims to wipe out an $887 million deficit. But the revenue assumptions in that document look suspect, considering that the local economy is still not in recovery mode. Nevada is the only one of the 50 states whose economic indicators continue to trend downward.

New Jersey

207.4



With a July 1 budget deadline looming, Republican Governor Chris Christie and the Democratic-controlled legislature remain far apart on a plan to bridge a roughly $11 billion shortfall. The latest scuffle was over a proposed income-tax increase on residents earning at least $1 million, which Christie vetoed on May 21.

Michigan

207.0



Michigan is expected to close out its fiscal year with a deficit as high as $500 million. The Democratic-led House and Republican-run Senate are at odds over proposals to cut aid to public universities and reduce spending on community health programs. But with an Oct. 1 deadline for a new budget, they still have time to hammer out a deal.

New York

203.8



Its Apr. 1 budget deadline long past, New York's dysfunctional legislature remains divided over a $9.2 billion deficit. Democratic Governor David Paterson says he's "virulently opposed" to issuing new debt to close the gap, though he may cave in the face of resistance from public sector unions to education and health-care cuts.

FROM LEFT: KURT KRIEGER/CORBIS; GEORGE ROSE/GETTY IMAGES; STEVEN PUETZER/GETTY IMAGES; AKIRA SUWA/GETTY IMAGES; ALAN COPSON/GETTY IMAGES; DON EMMERT/AFP/GETTY IMAGES

production, which in turn exacerbates price deterioration. Representative Jim Costa (D-Calif.) in mid-May offered a bill that would require dairies that boost production to pay into a fund that would distribute cash to those who don't. The larger concern of many family dairies is that the industry is a rigged game favoring a few powerful players. "There's no correlation between the milk price and how many farmers there are, or consumption," says Joel Greeno, a dairy farmer from Kendall, Wis., who is on the executive committee of the National Family Farm Coalition.
—*Alison Fitzgerald*

The bottom line *After a decade of dairy farm crises, antitrust enforcers and regulators are starting to scrutinize market power.*

Financial Regulation

How Wall Street Gamed Derivatives Reform

▸ Banks own stakes in trading and clearing firms

▸ "There's a potential conflict of interest"

Forcing derivatives trading out of Wall Street's dark corners is one of the most contentious issues in the financial regulatory revamp debate. No mystery here: The five biggest U.S. dealers—**JPMorgan Chase, Goldman Sachs, Morgan Stanley, Bank of America**, and **Citigroup**—generated an estimated $28 billion in revenue last year trading derivatives, according to Federal Reserve reports and people familiar with banks' financials.

Yet a sweeping overhaul, now in a House-Senate conference committee, likely won't have the transformative impact on the derivatives market some hope. (Derivatives are instruments that let companies hedge interest-rate risks or changes in commodity prices; they are also used for speculation.) Wall Street firms have known for more than a year that change is coming and have moved to protect their market role. Both the House and Senate bills mandate that most contracts in the unregulated $615 trillion over-the-counter derivatives market be traded on an exchange, or "swap execution

facility," a creation of Congress so far only partially defined in the legislation. The measures also require third-party clearinghouses to process trades, guaranteeing the contracts.

For regulators and companies, this would be a big improvement. Banks now conduct most trades over the phone, keeping bid and ask prices private and spreads, the main driver of profits, high. Until the credit markets crashed, regulators had little idea how much derivatives-related debt banks were taking on or how interconnected they were.

Big bank derivatives dealers hope to keep a tight grip on the $25 trillion credit-default swaps market by sending a large volume of that business to **ICE Trust**, a U.S. clearinghouse owned by Atlanta's **Intercontinental Exchange**. ICE Trust has processed more than $5 trillion in credit-swap transactions since March 2009, while its sister operation in London, **ICE Clear Europe**, has done close to $3 trillion. And as of April, ICE Trust is sharing 50% of its profits with the Big Five and other large banks—ensuring continued order flow.

The profit-share agreement gives the banks an incentive to send all their trading to ICE Trust, says Mark Williams, who teaches finance at Boston University. In contrast, Chicago's **CME Group**, the world's largest futures exchange, and **LCH.Clearnet**, Europe's largest clearinghouse, have taken only a fraction of the business. "Regulators need to monitor the relationship between these profit-sharing partners and Intercontinental," Williams says. "There's a potential conflict of interest." ICE Trust has an independent board of directors and advisory committee, counters spokeswoman Kelly Loeffler. Regulators in the U.S. and Europe have reviewed Intercontinental's governance and oversee its operations, she adds.

One of Congress's goals with derivatives legislation is to increase competition and lower the cost of hedging. ICE Trust, however, requires members to have a minimum net worth of $5 billion, a pricey admission ticket for smaller brokers.

The biggest players in the $349 trillion interest-rate swaps business, the largest OTC derivatives market, have also moved to protect how they buy and sell swaps with customers. One example: Goldman and nine other dealers own stakes in **Tradeweb**, a

Quoted

"Although NFL teams have common interests such as promoting the NFL brand, they are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned." —Supreme Court Justice John Paul Stevens, in a 9-0 decision on May 24 that subjected 32 National Football League teams to antitrust laws when licensing trademarks



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trading system majority-owned by **Thomson Reuters**. Tradeweb lets asset managers swap interest rates with dealers over an electronic system, or by phone. Earlier this month, Tradeweb said it would apply to become a swap execution facility. Created in 2005, Tradeweb has helped conduct more than 55,000 rate swaps, with more than $5 trillion in notional value. Inter-dealer brokers, firms that arrange trades between banks, could also enter the picture as swap facilities, says Christopher Giancarlo, chairman of the Wholesale Markets Brokers' Association Americas. **Bloomberg**, the parent company of *Bloomberg Businessweek*, which already has an interest-rate swap platform, also plans to register as a swap facility, says Ben MacDonald, Bloomberg's global head of fixed-income products.
—Matthew Leising

The bottom line *The regulatory rewrite may dent the profits of Wall Street firms even as their stakes in trading and clearing companies benefit.*

Drawing Board



Gulf Oil Spill

Obama and the Dreaded Katrina Comparison



▶ **The President is set to tighten oil drilling rules and head to the Gulf**

▶ **Obama needs "his 'bull horn' moment on the Gulf catastrophe."**

Ever since the oil spill drama began in the Gulf of Mexico more than a month ago, President Barack Obama has managed to deflect politically damaging comparisons with the George W. Bush Administration's botched handling of the 2005 Katrina hurricane disaster in New Orleans. Yet last week, with the arrival of televised images from the Louisiana marshland of oil-coated birds and other marine life, the level of public anger reached another plateau and prompted a push by Obama to get out in front of the crisis.

On May 27, Obama was expected to unveil new regulations for offshore drilling, including updated permit procedures for oil rigs and tougher inspections to ensure that safety and environmental rules are being followed, an Administration official said on the condition of anonymity.

That same day, the President was set to receive a report from Interior Secretary Ken Salazar on the cause of the Apr. 20 rig explosion. (As *Bloomberg Businessweek* went to press, **BP** engineers were attempting to plug the gushing well with mud-like drilling fluid and cement.) Salazar said the U.S. has decided to review **Royal Dutch Shell**'s plans to explore for oil and natural gas in Alaska's Beaufort and Chukchi seas, even as he renewed the U.S. commitment to drilling. "We need to move forward with oil and gas development in the outer continental shelf," Salazar told a House panel on May 26. Shell's application to drill exploratory wells was conditionally approved last year by Salazar, and drilling could begin within months off Alaska's coast.

On May 28, Obama was set to make his second visit to the Gulf region. Even some fellow Democrats say the President needs to take stronger action to halt the slow-motion environmental disaster in the Gulf. "It's inexplicable," says Louisiana native James Carville, a Democratic consultant who moved to New Orleans after Katrina. "Why do we still not know how much oil has been pumped out? Why did it take us over 30 days to get the pictures?"

A poll released on May 25 by the Pew Research Center for the People & the Press showed a public critical of the Administration as well as BP. It found 26 percent of those polled rated Washington's response poor and 31 percent called it "only fair." What's missing is a sense that Obama has taken charge, says Presidential historian Douglas Brinkley, a professor at Rice University in Houston. "Obama has yet to have his 'bull horn' moment on the Gulf catastrophe," says Brinkley, invoking the image of Bush speaking to New York firefighters after the September 11 attacks. "As the weeks turn into months you can feel, almost on a daily basis, the public's furor start heading toward the White House."

The White House says it's taking a tough line toward BP and won't rest until the well is capped and the mess cleaned up. Obama has ordered a bipartisan commission to investigate the spill in the Gulf. "Nobody is more upset than me, because ultimately, like any President, when this happens on your watch, then every day you are thinking, 'How does this get solved?'" Obama said at a May 25 Democratic Party fundraiser in San Francisco. **B**
—Kim Chipman, Edwin Chen, Jim Efstathiou Jr., and Nick Johnston

The bottom line *Obama is trying to stay out in front of the Gulf oil disaster to avoid a Katrina-like political setback.*

FROM TOP: ILLUSTRATION BY RJ MATSON/ROLL CALL/CAGLE CARTOON; SAUL LOEB/AFP/GETTY IMAGES

Charlie Rose talks to

Bashar al-Assad



Syria's President on what the U.S. doesn't understand about the Mideast and the prospects for peace

Senator John Kerry, chairman of the Senate Foreign Relations Committee, was here in Damascus on May 22. Is something happening in the relationship between Syria and the U.S.?
The main interest of this Administration and of Senator Kerry is how can we relaunch the peace process.

It is said he came here as an emissary of President Obama. What is possible with respect to relations with America?
If [America] wants to play the role of the arbiter, it cannot play that role while it is siding with the Israelis. It has to be an impartial arbiter. It has to gain the trust of the different players. If you don't have good relations with Syria, how can Syria depend on you as an arbiter?

Has Senator Kerry convinced you that Syria is a high priority for this Administration?
I trust Senator Kerry, and I think he's genuine. But in the end, you have the Administration and you have the Congress; anyone could put up obstacles. I'm convinced President Obama wants to do something positive. I'm not confident [Congress] will allow him to do what he wants.

There are those in America who would like there to be some distance between Syria and Iran.
They contradict themselves. They talk about stability in the region. Stability starts with good relations. Iran supported our efforts to get back our land in 2008 when we had indirect peace negotiations [with Israel] in Turkey.

Let me underline that. Even though Iran says that it does not recognize Israel's right to exist, it was supportive when you were trying to negotiate with Israel?
Exactly.

Does America misunderstand Iran?
They misunderstand the region. And that's normal because it's a different culture. But after September 11, they should learn what's happening beyond the ocean. It's not about what you think. It's about what we think.

What doesn't the U.S. understand?
They don't understand that we want peace. But that doesn't mean we sign a capitulation agreement.

Washington believes that Syria has supplied scud missiles to the Lebanese militant group Hezbollah.
This is very good story by the Israelis. We told them, what evidence do you have? You are scanning the border between Syria and Lebanon 24 hours a day and you cannot catch a big missile—scud or any other? This is not realistic.

Some find it interesting that your allies are Islamist, yet Syria is a secular state.
This is one of the things that they don't understand in the West. If I support you, that doesn't mean I'm like you or I agree with you. That means I believe in your cause. There's a difference. We support the Palestinian cause, and Hamas is working for that cause. Hezbollah is working for the Lebanese cause, so we support that cause, not Hezbollah.

Do you believe Israel wants peace?
I think people who elect such an extremist government don't want peace. But that doesn't mean we have to stop working for peace.

So what is your big challenge today?
The biggest challenge is how can we keep our society as secular as it is today. We are proud of our rich diversity in Syria. But in the end, we are part of this region. You cannot stay unrelated to the conflicts surrounding you. Even if you have sectarian Lebanon to the west and sectarian Iraq to the east, if you don't have the peace process solved on our southern border and you have the terrorists dominating the region, you will be affected some day. You will pay the price.

Some people find a cause in religion.
They always assume the mantle of religion or Islam or whatever in order to have followers. But it's about how much can they influence the society. As long as we have open-minded people, [the extremists] are going to be isolated.

If you could convince all of them—Hamas, Hezbollah, Iran—to recognize the right of Israel to exist and have relationships with its government, would you do it?
If we have peace and we are sure that we are going to have our land back and we are sure that Israel will live normally like any other country in this region and not commit any crimes or aggression, of course. B



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▶ Twitter seizes control over tweets—and ads 36 ▶ Jason Matheny dreams of pork from a petri dish 38 ● Edited by Jim Aley

Technology



Callinicos called in Google engineers to customize trading software

Google's Latest Launch: Its Own Trading Floor

▶ **The search giant is hiring Wall Street vets to manage a $26.5 billion pile of cash**

▶ **"This isn't fast money, this is patient money," says Google treasurer Callinicos**

Last fall, some unusual job listings began cropping up on **Google**'s website. Amid the requests for programmers and engineers were postings for bond traders and portfolio analysts. By spring, tech blogs were speculating about what was going on at Google.

The answer was very un-Silicon Valley. Google, it turns out, has launched a trading floor to manage its $26.5 billion in cash and short-term investments. The hoard is the third-biggest cash pile among U.S. tech companies, after **Microsoft** and **Cisco**'s.

One of the company's goals is to improve the returns on its money, which until now has been managed conservatively. Google doesn't disclose its rate of return on investments or the targets it has set, but analyst Aaron Kessler of ThinkEquity estimates the company's 2010 return (including interest income and realized and unrealized gains before tax) at around 2.5 percent. That's a higher return than some other large Internet outfits, such as **Yahoo!** and **Amazon**, he says.

Google is using some of its money to buy back shares in the wake of its $750 million acquisition of mobile advertising firm **AdMob**, which was an all-stock deal. The transaction was cleared by U.S. regulators on May 21. Investors have been wondering what else the company intends to do with its cash. **IBM** recently announced plans to spend $20 billion over five years on acquisitions. **Hewlett-Packard** just bought **Palm** for $1.2 billion. "Google could do 10 Palm kind of deals," says Michael Yoshikami, president and chief investment strategist of YCMNET Advisors, which owns Google shares. "That would be a pretty decent use of their money." Beyond the AdMob buybacks, Google has said it has no plans to return cash to shareholders.

The plan is to keep the war chest growing and ready to be deployed should the right M&A opportunity arise

PHOTOGRAPH BY AMANDA FRIEDMAN FOR BLOOMBERG BUSINESSWEEK



Will gold hit $1,500 an ounce? page 44 ▶

Google's trading room opened in January. The plan is to keep the war chest growing safely and ready to be deployed should the right mergers-and-acquisitions opportunities arise. The investment team has grown to more than 30 people, up from six three years ago. Many of the new arrivals are former Wall Streeters who left lucrative careers at **Goldman Sachs**, **JPMorgan Chase**, and other banks. The man in charge is Brent Callinicos, Google's 44-year-old treasurer, who joined from Microsoft in 2007, back when Google had $11 billion in cash. "This isn't fast money, this is patient money," he says. His crew works in a recently remodeled finance building on the company's corporate campus in Mountain View, Calif., complete with a rock climbing wall, massage chairs, murals of tropical sunsets, and bamboo wall panels. In a second-floor space accessed by key card—the trading room—the Wall Street vets tap out trades at desks with six computer screens.

Craig A. Jeffery, managing partner of Atlanta-based consultant Strategic Treasurer, says the financial technology at banks and most corporate treasuries tends to be an unwieldy hodgepodge of disparate software applications. If you're crunching numbers in Excel, you probably have to cut and paste the results manually into your foreign-exchange analytics software. Callinicos got around the coordination problem by tapping in-house engineers to meld the various pieces of software into one dashboard for trading and managing cash. "Callinicos built this mosaic of systems and a way of relating them together," says Jeffery.

That woven-together technology gives Google a trading advantage: It shows the value of the company's holdings all over the world in near-real time. This is harder than it sounds. Jeffery says that most treasuries with dozens of bank relationships in multiple countries can see the values of only 60 percent or 70 percent of their positions at any given time. Google's systems can monitor 98 percent of its holdings in real time, says Callinicos. "One of the toughest parts of [managing cash] is extracting the right data for the right decisions at the push of a button," says Wolfgang J. Koester, CEO of FiREapps, a maker of financial software. Callinicos "has been an industry leader on this."

Born in South Africa, Callinicos came to the U.S. at age 16. After receiving an MBA from the University of North Carolina, he landed in Microsoft's finance department in 1992 and became treasurer in 2000. By the time Microsoft's cash neared $60 billion in 2004—the year the company paid out a one-time $32 billion dividend—it was generating returns of more than 7 percent.

After a couple years of cautious cash management at Google, Callinicos says he's beginning to build a higher-risk, higher-return portfolio. Since last year he has pulled away from U.S. government notes and moved into corporate debt securities ($4.9 billion as of Mar. 31, up from $695 million the year before), agency residential mortgage-backed securities ($3.3 billion, up from $60 million), and foreign government bonds ($332 million, up from zero).

Google is still building its team. Its website lists openings for a foreign government bond trader, a risk analyst, and a portfolio analyst of agency mortgage-backed securities. Callinicos says he's looking for different qualities than those that large banks are seeking. "We're not trying to become a Wall Street firm," he says. "This is Google. It's eclectic." He cites Ranidu Lankage, who came to Google after a full-ride at Yale and a two-year stint at Lehman Brothers. When he's not analyzing Google's portfolio, Lankage is a star of Sri Lankan-style rap and R&B. He landed his first record deal with Sony at age 19.

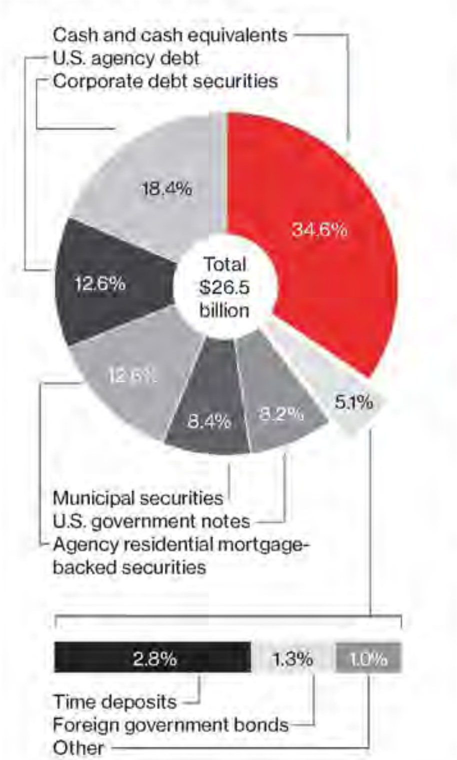
Callinicos wouldn't comment on what he pays his staff, though Gustavo G. Dolfino, senior managing director at financial recruiting firm Accretive Solutions, says Google pays finance staffers significantly less than what they would make on Wall Street. (Google has not retained Accretive Solutions.) He adds that what Google jobs lack in pay they make up for in stability. "Everybody knows that Google isn't going anywhere."

—Douglas MacMillan

The bottom line *Google built a state-of-the-art cash-management system to improve returns. It may use that money on future deals.*

Google's portfolio

Breakdown of its cash and short-term investments as of Mar. 31



Quoted



"We are certainly not running a sweatshop." —Terry Gou, chairman of Taiwanese contract manufacturer Foxconn, commenting on May 24 about a rash of suicides at the company. The following day, a 19-year-old employee died after falling from a company building in Shenzhen.

Biotech

Training the Immune System to Fight Cancer

▸ **Bristol-Myers' new melanoma drug may be a "game changer"**

▸ **"The tumor no longer has the upper hand," says one oncologist**

For more than three decades, scientists have dreamed of unleashing one of nature's most powerful forces, the immune system, on cancer. Now, a wave of immune therapy treatments is beginning

FROM TOP: DON FARRALL/GETTY IMAGES; MAURICE TSAI/BLOOMBERG; COMPANY FILINGS (GOOGLE CHART)

to emerge from drug-company laboratories, giving the possibility of longer life to patients with terminal lung cancer, leukemia, brain tumors, and melanoma. The first drug designed to train the body's natural defenses to attack tumors is **Dendreon**'s Provenge, a prostate-cancer vaccine cleared by the U.S. Food & Drug Administration on Apr. 29.

Beginning on June 4, at the American Society of Clinical Oncology conference, the world's biggest gathering of cancer doctors and drug and biotech companies will show how medicines now being developed will provoke the immune system to kill cancer cells. **Pfizer** will present data on a brain tumor vaccine. A Bethesda (Md.)-based startup, **Micromet,** will tell doctors about its technology for shrinking tumors. German drugmaker **Merck KGaA** and **Oxford BioMedica** of the U.K. will show how their vaccines work against breast and kidney malignancies.

What's getting the most buzz is **Bristol-Myers Squibb**'s experimental drug for skin cancer. Caught early, the disease is often treatable; late-stage melanoma is usually fatal. Bristol-Myers' drug, which has the generic name ipilimumab, seems to be effective in fighting the disease even in its deadly advanced phases. In three small trials the drug kept more than a third of patients alive for at least 18 months, about a year longer than existing treatments for terminal melanoma.

Bristol-Myers' report at the conference will reveal the outcomes of a larger study. If those results are as impressive as the early trials, ipilimumab may get U.S. regulatory approval as early as next year, which would put the drug in doctors' hands in 2012, according to the company. "We have hundreds of patients who are still alive after taking this treatment, and that is something unheard of" in advanced-stage melanoma, said Renzo Canetta, Bristol's vice-president of oncology clinical research.

Ipilimumab is derived from mice that were genetically altered to create a human version of an antibody. The antibody speeds up the immune system so that white blood cells attack cancerous tumors, says Steven O'Day, who tested the drug on patients at the Angeles Clinic & Research Institute in California. The drug does this by blocking a

Speed Dial

Ballmer: 'China Can't Get a Lot Worse'



JEFF HOLT/BLOOMBERG

Microsoft's CEO, visiting Hanoi on an Asian tour, talks a little about opportunities in Vietnam and a lot about why China is such a problematic market

Why start your Asian tour here in Vietnam, which has one of the worst software-piracy rates in the world?
It's a place we want and need to see improvements in IP [intellectual property] protection. China and Vietnam are in the most need of improvement in the IP protection area. India is much better, Indonesia is much better.

With the PC market developing rapidly in Vietnam—the young population, the number of students graduating—we see a lot of opportunities. We are trying to stimulate use of our software.

What excites you about Asia now?
Two things make a country an interesting place: One, they buy a lot of personal computers; and two, they pay for the software that gets used in those PCs. India is exciting to us. Indonesia is exciting to us.

China is in a class by itself: There is no software market to speak off. China is a lot less interesting market to us than India or Indonesia.

If you look at the numbers today, how we do in China vs. the U.S., we do about 10 times better in the U.S. per PC sold. Maybe 20 times. We do seven times better in India. China can't get a lot worse. We haven't given up on China, but from a Microsoft perspective, we do more business in India, we do more business in Korea.

What percentage of Microsoft's $60 billion revenue comes from Asia, excluding Japan?
Three percent.

Just three percent?
How big is the PC market in these countries? It's a third of the world's computers, maybe 25 percent—and yet maybe 3 percent of our revenue. IP protection is critical, particularly in China.

Could Microsoft's online business in Asia help, especially given the recent setbacks for Google in China?
The market leader for search in China is Baidu, which has total revenue of only $400 million or $500 million. If we owned Baidu, it would account for 1 or 1.5 percent of our revenue. I don't think there's a solution that will be in search. I think we will also have to be successful with our business customers, which means improved IP protection. There is just no substitute for that.

Do you see any signs of progress? Microsoft has won some high-profile court decisions in China recently.
I am encouraged by that, it's a good start. I hope it sets a trend. I want to be optimistic about China ... [however] the level of protection for IP is not very high. We keep working inside China, but we see better opportunities in other countries.

—*Bruce Einhorn and Mark Lee*

Technology

protein called CTLA-4, which helps regulate the immune system.

Early trials suggested the drug didn't work. Tumors just kept on growing, and some patients were getting even sicker with symptoms such as painful skin lesions, diarrhea, or organ damage. Then the researchers realized that what appeared to be worsening cancer was an inflammatory response from the treatment as the good cells attacked the tumor and other tissue; those painful symptoms were signs that ipilimumab was doing its job. "Had we been too rash and said this drug is never going to make it, that would have been a tragic mistake," says Bristol's Canetta.

The drug may also be effective against tumors of the lung and prostate, says Trevor Polischuk, an analyst with OrbiMed Advisors in New York. "This could be a game changer," he says. Linda Bannister, a health-care analyst at Edward Jones & Co., says the drug could generate $1 billion in annual sales within five years.

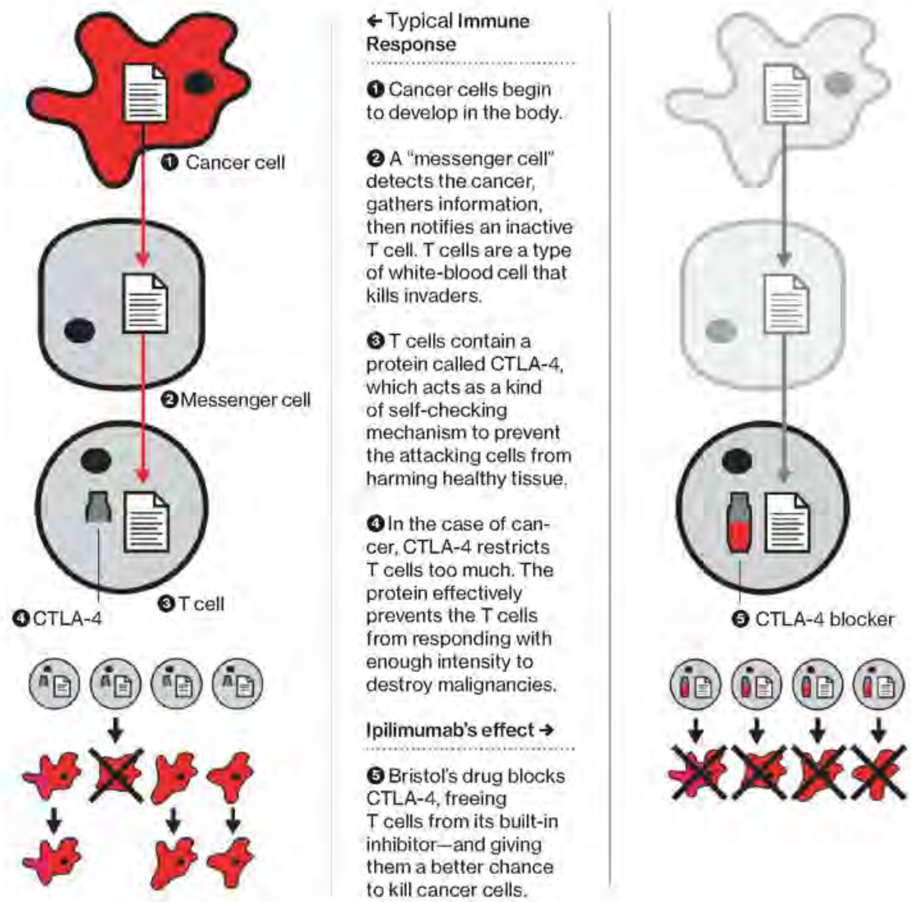
The concept of immunotherapy has been around a while. In the early 1970s scientists started developing lab-grown proteins called monoclonal antibodies, designed either to block tumor growth or make tumors visible to immune-system cells. They do this by homing in on specific molecules or "targets" on the surface of cancer cells. The first monoclonal drug to be commercially successful was Rituxan, a non-Hodgkin's lymphoma treatment launched in 1997 by **Genentech** and **Biogen Idec**.

While these older drugs are a big business for drug companies, most have shortcomings as medicines, says Steven Rosenberg, chief of surgery at the National Cancer Institute in Bethesda, Md. Tumors in many patients grow resistant to the treatments. "We need to do better than prolonging survival by months," Rosenberg says.

Next-generation immunotherapies such as ipilimumab may be more effective for longer periods. Instead of focusing on a single target, they train the immune system to destroy cancer cells the way they would a virus. "The hope is there that we aren't just extending [the lives of patients], but that we are really curing people with widespread cancer," O'Day says. "It is a little early to say that, but there is hope."

How Bristol-Myers' New Cancer Drug Works

The experimental melanoma treatment ipilimumab may get U.S. federal approval next year. The left column shows typical immune-system response to cancer. The right shows how Bristol-Myers' compound unleashes the body's natural defenses to attack tumors.



Jedd Wolchok, a skin cancer specialist at Memorial Sloan-Kettering hospital in New York, says he realized ipilimumab was unlike any drug he has seen for melanoma shortly after he started testing it in 2004. One of the first patients Wolchok treated with it was a 24-year-old woman who likely had less than a year to live after other treatments failed. Her tumors eventually disappeared. She has since started a family. "We are resetting the balance between the person and the tumor, and the tumor no longer has the upper hand," Wolchok says. "We have been talking about turning cancer into a chronic disease, and this shows it is possible."
—*Shannon Pettypiece and Ellen Gibson*

The bottom line *A wave of new immunotherapy drugs may help turn some lethal cancers into manageable chronic diseases.*

Internet

To Protect Advertising, Twitter Walls Off Tweets

- **The social network bans paid tweets except on its own site**
- **"There's no one to stand up to them, and they know it"**

In April, **Twitter** began selling "promoted tweets," little ads among those ubiquitous, 140-character messages. Brands—including **Starbucks** and **Best Buy**—post ads that appear if users search for certain terms on the site. If someone enters "Red Bull" in the search box on Twitter.com, a paid tweet from the beverage maker may appear



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among that person's messages from other users. The advertising is crucial to the four-year-old site, which attracted 110 million users before it had fully articulated a business model.

Recently a raft of websites and mobile-phone apps–from **Seesmic** and **TweetDeck**, to name two–have cropped up to consolidate tweets with streams of messages from **Facebook**, **LinkedIn**, and other social networks. Twitter's position on this proliferation of third-party sites and apps has been benign. Until now.

On May 24, Twitter declared that companies using its material may put ads above, below, and around the tweets–but not *among* them. In other words, that advertising venue is reserved for Twitter itself. Dick Costolo, Twitter's operating chief, wrote in a post on the company blog that paid tweets on other sites could hinder efforts at "innovating or creating the best user experience." Says Twitter spokeswoman Carolyn Penner: "We're working with companies in the ecosystem to help them understand the policy."

What set Twitter off was that some third-party operators started selling ads among tweets that appear on their sites. Startups such as **Ad.ly** and **Izea** emerged as brokers for these paid tweets.

That policy will force developers of the third-party sites and mobile apps to diversify. "It would be really dangerous to be only relying on Twitter," says Loic Le Meur, chief executive officer of Seesmic. While Seesmic now gets about two-thirds of its content from Twitter, Le Meur says that number will drop to one-third as he pulls other social networks into the fold.

Tech companies have tangled with members of their ecosystems before. **Apple** has refused to allow some of **Adobe**'s software to work on the iPhone and iPad. Facebook has had a tense relationship with gamemakers like **Zynga**. Then again, Adobe and Zynga are powerful companies in their own right. No one in Twitter's world has much negotiating power, says John Malloy, co-founder of BlueRun Ventures and an investor in Facebook and Twitter developers. "There's nobody to stand up to them," he says. "And they know it." B

—*Ari Levy*

The bottom line *Twitter, which has fostered a world of compatible apps and websites, is asserting control over how ads get mixed in with tweets.*

Innovator

Jason Matheny



A 35-year-old MBA with a green streak is working with scientists around the world to bring lab-cultured meat to the carnivorous masses

Jason G. Matheny wants to take a single stem cell and make meatloaf.

In 2004, Matheny, then 29, created a nonprofit called New Harvest to turn that idea into reality. Thanks in part to his efforts, meat made in petri dishes may arrive at supermarkets within 5 to 10 years. "It's a way to satisfy the growing global demand for meat in a way that's healthier, more energy efficient, and sustainable," says Matheny, who has an MBA from Duke University and is studying for a PhD in applied economics at Johns Hopkins University.

Matheny's meat starts in a lab, where scientists extract stem cells from animal muscles. The cells are placed in a nutrient bath to develop and then on plastic scaffolding that allows them to form into strips as they multiply. Mark Post, a professor of tissue engineering at Eindhoven University of Technology in the Netherlands, may be close to realizing New Harvest's vision. Post's lab is producing 2 mm thick strips that are almost an inch long and a quarter-inch wide. Pack enough together, and you've got a meal.

Matheny's interest in changing the world's dietary habits began at age 13, when the Kentucky native first visited what he describes as a "factory farm" in his home state. The experience unsettled him. "Tens of thousands of animals are raised shoulder-to-shoulder, living in their own waste, pumped full of drugs, in a shed," Matheny says. "That, to me, is less appealing than making meat in a sterile facility. This process is like [growing] hydroponic vegetables, in a way."

Matheny claims that test tube meat could do more for the environment than "everyone trading their cars for bicycles," and he has a point: The meat industry generates some 18% of the world's greenhouse gases, according to a 2006 UN report. That proportion is expected to grow as consumers in developing countries such as China and India consume more meat.

Matheny spent $5,000 of his own money to get New Harvest off the ground. The nonprofit has no paid employees and draws contributions of less than $50,000 a year, he says. Matheny's outfit has helped fund research at Oxford University in the U.K. and Utrecht University in the Netherlands. Yet its main mission, according to its founder, is serving as a "clearinghouse for information and research findings." It was an academic paper on the feasibility of cultured meat co-authored by Matheny and published in 2005 that persuaded the Dutch government to fund Post's work at Eindhoven.

Though that research is probably the most advanced in the field, the scientist acknowledges that there are challenges to be surmounted before his in vitro pork can move onto dinner plates. One problem is flavor. Post hasn't tasted his own handiwork because he says he's averse to eating his experiments. But he's been told by those who have that it doesn't taste like the real thing. Pig farmers everywhere can breathe easy–at least for now. —*Elizabeth Lopatto*

Goal ▸ A sustainable alternative to livestock farming

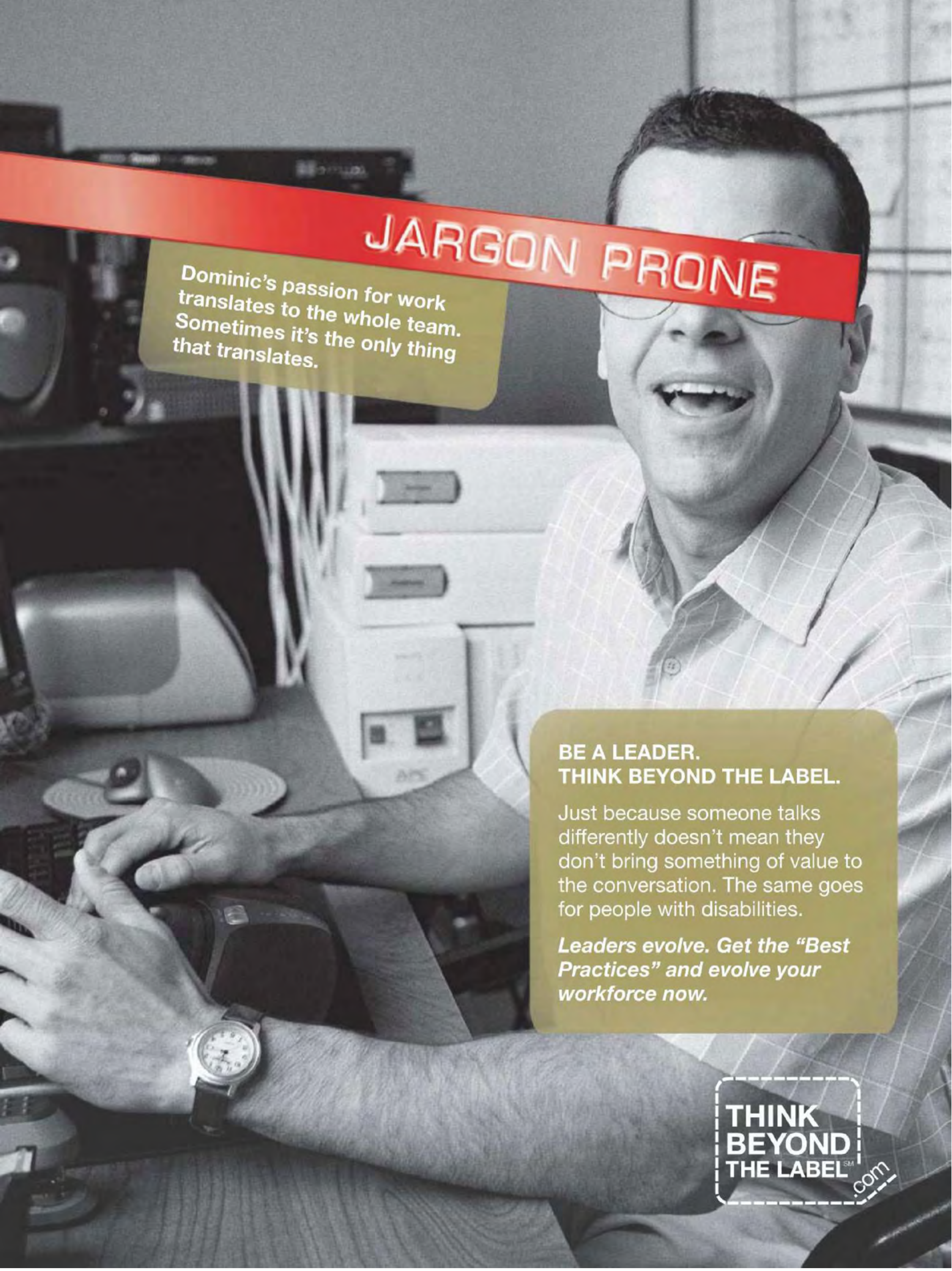
Background ▸ MBA; PhD candidate in applied economics

Quote ▸ "This ... is like [growing] hydroponic vegetables"



(Meat)

FROM TOP: DAN DRY; COURTESY OF MAASTRICHT UNIVERSITY


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The Global Battle Over New Rules for Banks



The EU's Barnier is working with regulators on guidelines due in December

DOMINIQUE FAGET/AFP/NEWSCOM

▶ **Basel III tries to correct the mistakes that led to the meltdown**

▶ **"There's a balancing act that politicians need to play"**

A week before the Senate passed legislation to overhaul the banking industry, Michel Barnier, the EU's financial-services commissioner, was in Washington eating scones and sipping coffee with Treasury Secretary Timothy F. Geithner. On the agenda was an issue that may have an even greater global impact than the reform bill: new international rules being considered by the Basel Committee on Banking Supervision.

The Barnier-Geithner meeting is evidence of the growing role of politicians in setting global banking rules. The 36-year-old Basel committee, made up of central bankers and regulators from 27 countries, is responsible for setting international bank capital standards—essentially, the reserve a bank must hold as a buffer against losses, which affects how much money it can risk in the markets. According to an estimate by UBS, banks may need to raise $375 billion of fresh capital to comply with the new rules. **JPMorgan Chase** predicted in February that the rules would cut annual earnings at 13 of the largest banks by $20 billion.

The committee has circulated preliminary proposals and is now evaluating comments on them from banks and government officials. It plans to publish final rules by December; it will then be up to individual nations to adopt them.

An earlier revision, known as Basel II, was initiated by lenders in the late 1990s during an era of deregulation. Basel II lowered capital requirements by as much as 29 percent for some banks, according to a 2006 study by the Basel committee. Now, following the worst financial crisis in more than 70 years, the process is being driven by politicians, and bankers may have less influence, members of the committee and bank lobbyists say. "Governments have realized they need to be more involved in the capital standards of their banks," says V. Gerard Comizio, a former Treasury Dept. lawyer, now a partner at Paul, Hastings, Janofsky & Walker in Washington.

"We can say with conviction now that Basel II failed. Regulators... are trying to fix the problems"

The Basel committee doesn't disclose the names of its members, publish minutes, or have a press officer. It gathers four times a year around an oval table in Meeting Room D on the first floor of a round, 20-story glass tower in Basel, Switzerland, according to one former participant. A request for a list of people attending meetings of the committee and more than a dozen subcommittees was turned down. "I don't think they've ever given those names," says Lisa Weekes, a spokeswoman for the Bank for International Settlements, which is housed in the same tower and provides support services for the Basel committee. The members who spoke to Bloomberg asked not to be identified.

The rules put forth under Basel II represented a paradigm shift: Instead of relying on standardized formulas, they allowed the largest banks to use internal models to calculate the risks of their assets to determine the capital charges against them. The drawbacks of that approach became clear during the credit crisis, when many banks found they did not have the financial strength to withstand the losses on investments that proved to be much riskier than the models suggested.

This round of changes, known as Basel III, was spurred by leaders of the G-20 nations, representing the world's major economies, who urged at meetings in April and September last year that the committee strengthen guidelines to improve bank safety and discourage excessive risk-taking.

While the new rules will continue to rely on banks' risk models, the committee has proposed tighter

The dot-gov Internet boom page 49 ▶



control of what goes into those calculations, a narrower definition of what counts as capital, and a requirement for banks to set aside extra money when they hold certain riskier assets. It also may impose a cap on the amount of assets a bank can have in relation to its equity and require banks to have enough cash to meet short-term liabilities.

"Basel III will be a very different animal," says Charles Goodhart, a former Bank of England policymaker and professor emeritus at the London School of Economics. "We can say with conviction now that Basel II failed. It led to a relaxing of capital minimums. Regulators now understand the lessons and are trying to fix the problems."

Banks in the U.S. and Europe are resisting some of the proposals. French and German banks have objected that the rules would have a disproportionate impact on European banks because European companies rely more on traditional bank loans for funding than their American counterparts, which are more likely to raise money in the capital markets. U.S. bankers complain that the new definitions of capital do not count certain securities used only by U.S. banks.

"There's a balancing act that the politicians need to play between making the system really safe and keeping it relevant," says Mark Flannery, a finance professor at the University of Florida in Gainesville who has tracked Basel for two decades. "If you restrict the banks too much, financial activity will be curtailed or it will shift to nonbanking institutions, making the rules irrelevant."

No matter how carefully constructed the new rules are, lenders may find ways around them, says Joseph Mason, a professor of finance at Louisiana State University in Baton Rouge: "Wall Street will always have more lawyers and more accountants and more brains than the regulators." *—Yalman Onaran, Simon Clark, and Joseph Heaven*

The bottom line *Higher capital requirements may cut bank profits, but they will help the system withstand the withering losses that led to the credit crisis.*

Drawing Board



ILLUSTRATION BY RJ MATSON/THE ST. LOUIS POST DISPATCH/CAGLE CARTOONS

Bankruptcies

Tom Hicks Says Goodbye to Sports

- Besieged by creditors, he's selling three major teams
- There are "some things I would like to do over again"

Thomas O. Hicks, who amassed a fortune in the 1990s with a series of lucrative leveraged buyouts, is departing the sports world with a mixed record. "Sports has never been my primary business," says Hicks. "We are systematically selling our sports assets to focus on our core businesses like private equity and real estate."

Last week the Texas Rangers filed for bankruptcy, about a year after its parent, **HSG Sports Group**, defaulted on $525 million of debt. The filing comes nearly 10 years after Hicks started the Rangers down the path to bankruptcy court by signing Alex Rodriguez to a record-smashing 10-year, $252 million contract. Rodriguez is the team's top unsecured creditor, owed about $25 million in deferred compensation, according to court documents. Hicks' proposal to sell the team for $575 million to a group headed by team president and Hall of Fame pitcher Nolan Ryan is being challenged by creditors. "We have a plan in place now for the Rangers that's very solid, and the club is positioned to be a contender," says Hicks.

Another HSG property, the Dallas Stars of the National Hockey League, is up for sale. And just over three years after agreeing to buy 18-time English soccer championship team Liverpool, Hicks and co-owner George Gillett Jr., mired in $341 million of debt, put it on the block. Hicks says he may lose a few hundred million dollars on the Texas Rangers and Dallas Stars; he expects to make that up when he sells his Liverpool stake.

Hicks, 64, built the Dallas firm eventually known as Hicks, Muse, Tate & Furst into a private equity powerhouse in the 1990s, before losses in telecommunications and media stocks dimmed its luster. In 2004, Hicks announced that he was leaving the firm, which was renamed **HM Capital**.

Hicks moved into sports independently of Hicks Muse. He bought the Dallas Stars for $84 million in 1995 and the Texas Rangers for $250 million in 1998. The ventures got off to a good start, riding a wave of growth for major league sports franchises. HSG Sports struck a 15-year deal in 1998 with the regional **Fox Sports** network that tripled the Stars' TV rights fees and doubled those of the Rangers. Fans flocked to the teams' new facilities–the Rangers' Ballpark at Arlington, opened in 1994, and the Stars' American Airlines Center in 2001.

Hicks personally courted Rodriguez in November 2000, negotiating the blockbuster contract with his agent, Scott Boras. With A-Rod on the roster,

Texas finished last in its division three times. Texas traded him to the New York Yankees in 2004. It remained on the hook for part of his salary while also continuing to pay expensive free-agent signees like pitcher Chan Ho Park, pushing the team's payroll over $100 million. "When I signed A-Rod, that got a lot of attention and it didn't work out well for us," says Hicks. "With the Rangers I've clearly done some smart things and some things I would like to do over again."

One mistake was piling up debt as the Rangers were sinking in the American League West. During the boom years, that might not have been a problem. After the financial crisis hit, the cost of financing soared, and the pool of potential buyers shrank—as Hicks found when he put the Rangers on the market in 2009. "The universe of potential buyers was always small, and that universe has contracted with the economy," says Michael J. Cramer, a former president of the Rangers and the Stars who teaches sports business management at New York University. Says Hicks: "Clearly HSG got into excess leverage during the credit bubble."



Hicks signed Rodriguez, now the Rangers' top unsecured creditor

Buyout skills may not have helped Hicks run big-league teams. "Success in the sports sector is about operational engineering," says Steven N. Kaplan, a finance professor at the University of Chicago Booth School of Business. "There's too much volatility in a team's performance and attendance for financial engineering, which is what Hicks was known for."

Having every move scrutinized is something Hicks will not miss. "The lack of privacy in sports is something that my family and I aren't willing to undertake any longer," he says. "We'll always be big fans, but we want our privacy back."
—*John Helyar and Jonathan Keehner*

The bottom line *In many respects, sports teams are like any other company. Load them with too much debt and they will run aground when credit dries up.*

TOP RIGHT: ROGER HUTCHINGS/ IN PICTURES/CORBIS; LEFT: RONALD MARTINEZ/ALLSPORT/GETTY IMAGES



A just-sold home in London, where subprime loans are available again

Mortgages

Subprime Lending Returns to the U.K.

- Now it's called "complex" or "almost" prime
- "It's very different from where we were in 2007"

Three years after defaults on U.S. subprime mortgages sparked a devastating financial crisis, lending to borrowers with less-than-perfect credit histories is making a comeback in Britain. **General Electric**'s GE Money unit and **Investec**'s Kensington division have started lending to customers rejected by mainstream banks. This time they say their loans are for less money and are going to clients with better credit histories than during the housing boom. And they avoid the word "subprime" to describe these borrowers, preferring the terms "complex prime" or "almost prime."

" 'Subprime' sends messages out that people are lending money to individuals who can't repay it," says Gerry Bell, marketing director for GE Money's U.K. mortgage unit. "Our customers have clear track records," though some may have had "minor credit blips."

Kensington, which stopped offering mortgages to customers with spotty credit histories in November 2007 and halted prime mortgage lending in August 2008, restarted lending to prime customers in November and reentered what it now calls the "complex prime" market at the end of March. The lender accepts borrowers with up to two court judgments for failing to pay debts of as much as $1,080, through a product called "Prime One." Before the credit crunch, Kensington would accept borrowers with existing arrears and with judgments of as much as $10,800, says spokeswoman Karen Agombar. Today it will lend only up to 80 percent of the value of a property, down from 90 percent before.

GE Money is lending to people who have defaulted on loans, including mortgages, twice before and to borrowers with a single judgment. The loans are financed by GE, its parent. Bell says these loans are less risky than previous subprime mortgages: "It's very different from where we were in 2007."

Of course, "it's different this time" is a dangerous phrase. So far, though, there are few signs of a return to the excesses of the bubble years, according to British debt advisers. "We haven't come across inappropriate lending" in the nonprime mortgage market this year, says Beverley Budsworth, managing director of the Debt Advisor, which counsels consumers on debt issues.

Subprime has a long way to go to reach its 2006 level, when securitization, the process that saw loans packaged into bonds and sold to investors, helped fuel a lending boom. **Bank of America** plans to sell off $1.1 billion worth of bonds backed by higher-risk U.K. mortgages in what would

be the first public deal of its kind in the U.K. since August 2007.

The appeal of subprime lending is the same as ever: It is more profitable for banks (unless too many borrowers default). Subprime loans can be offered at more than double the interest rates of prime products. Kensington and GE Money offer mortgages to less-than-prime customers at 5.99 percent that convert to a floating rate after two years. The most creditworthy borrowers can get a similar product from **HSBC**'s First Direct bank for as little as 3.09 percent. *—Jon Menon and Kevin Crowley*

The bottom line *Although memories of the housing bust's losses are still fresh, lenders find it hard to resist the lure of high-interest-rate mortgages.*

Investing

Goldman Goes After Retirement Money

▶ Targeting a $2.7 trillion market with alternative asset funds

▶ "They see an opportunity to dominate that niche"

As **Goldman Sachs** fights an SEC lawsuit accusing it of misleading investors, it is trying to persuade more Americans to trust it with their retirement money. To appeal to 401(k) investors and the companies that sponsor the plans, it is promoting its alternative asset funds and designing target-date funds that will offer guaranteed income. "We understand risk and we understand asset allocation," says Bill McDermott, head of Goldman's defined-contribution business, who joined the firm in February. "We're looking to leverage that for the 401(k) market."

Goldman, a giant on Wall Street in trading and other businesses, is a relatively small presence in the retirement market. Its 401(k) plan assets totaled $17.5 billion as of Mar. 31, according to the firm. **Fidelity Investments**, the largest 401(k) asset manager, held $347.8 billion as of Dec. 31. Total assets in 401(k) plans may increase 41 percent, to $3.8 trillion, by the end of 2014, from $2.7 trillion today, according to data from Cerulli Associates.

The retirement savings business has been dominated by firms such as Fidelity and **Vanguard**, both of which administer plans and manage assets. Goldman and **BlackRock**, the world's largest asset manager, don't run plans and have been seeking to have their funds included in more 401(k)s.

The Securities & Exchange Commission filed a lawsuit on Apr. 16 accusing Goldman of misleading investors in a mortgage-linked investment. Goldman denies those allegations and says it will fight the charges. The asset management division that McDermott works in is separate from the mortgage unit that sold the securities at the center of the SEC's fraud suit. A key difference between the two businesses is that the asset management division operates under a fiduciary duty to its clients, while the sales and trading division doesn't. So far, there have been no reports of plan sponsors dropping Goldman funds. "Having issues certainly isn't going to help," says Teresa Epperson, a partner at Mercatus, a financial consulting firm. "But all the signs so far are telling us that clients are sitting tight."

Alternative assets, such as commodities and real estate, can increase a portfolio's return and lower risk. The market drop of 2008, when the Standard & Poor's 500-stock index declined 38 percent, showed "there were very, very, very few safe havens," says Bud Pernoll, senior managing director of Bay Mutual Financial, which advises corporate retirement plans on their investment options and works with Goldman. "You're starting to see plan sponsors look outside the traditional asset classes."

Pernoll has added Goldman's Satellite Strategies Portfolio to more than a dozen 401(k) plans he advises. Satellite Strategies invests in other mutual funds that put money into assets such as real estate, commodities, and emerging markets. The fund, with $585 million in assets, returned 17.1 percent in the 12 months through May 25, according to data compiled by Bloomberg.

Goldman's alternative asset push "is ahead of the curve, so they see an opportunity to dominate that niche," says Steven Dimitriou, managing partner of Mayflower Advisors, a retirement plan consultant. "As soon as these funds start gaining traction, they're going to get copy-catted." *—Amy Feldman*

The bottom line *Alternative assets, and the Goldman name, may appeal to retirement investors worried about market volatility.*



Making gold bars at a Rand refinery in South Africa, the world's largest

Precious Metals

Gold Rally: The Pause That Refreshes?

▶ Analysts see big gains as Paulson and other investors snap up bullion

▶ "What's surprising is that gold is still as low as it is"

Gold's long rally paused briefly in May, but analysts say it is far from over. Even though the price of an ounce of gold has fallen 3.6 percent to $1,204.25 as of May 25 from a record $1,249.40 on May 14, the median prediction in a Bloomberg survey of 23 traders, analysts, and investors suggests it may reach $1,500 by the end of the year, a 25 percent gain from today's level. "You could see gold go up another



$1,000," says Evan W. Smith, who helps manage $2 billion at U.S. Global Investors in San Antonio. In 2006 he correctly predicted that gold would reach $700 an ounce within two years. "All of the turmoil and problems we've seen in Europe are just another reminder that there's a lot of value in gold as a safe haven," he says.

Traditionally, investors favor gold when the dollar weakens and inflation gains. Yet the metal can also advance in times like these, when the opposite conditions prevail. Gold rose 5.8 percent in 2008, when U.S. consumer prices gained 0.1 percent. The metal added 18 percent in 2005 when the U.S. Dollar Index, a measure against six other currencies, advanced 13 percent. Gold rose 9.8 percent this year as the U.S. Dollar Index jumped 11 percent and U.S. consumer prices dropped in April.

What's up? Both the dollar and gold are benefiting from worries about the global economy. As some investors see it, the dollar will eventually succumb to those concerns as well. "People are afraid of the debasement of all the currencies," says Peter Schiff, president and chief global strategist for Darien (Conn.)-based Euro Pacific Capital. "What's surprising is that gold is still as low as it is." He predicts a price of $5,000 to $10,000 an ounce in the next 5 to 10 years.

Some big-name investors agree. Paulson & Co., the hedge fund run by billionaire John Paulson, is the biggest investor in **SPDR Gold Trust**, the exchange-traded fund that owns bullion. The fund owns 31.5 million shares, or about 96 tons, a May 17 regulatory filing showed. George Soros' **Soros Fund Management** was the sixth-biggest investor in the fund in the first quarter, according to a filing. He trimmed his holding by 9.6 percent from the previous quarter.

25%

Median forecast for gold's additional price gain this year

Central banks and governments are also buying gold, adding 425.4 tons last year, the most since 1964 and the first expansion since 1988, data from the World Gold Council show. They may expand their reserves, which now total 30,116.9 tons, by 192 to 289 tons this year, according to CPM Group, a research and asset management company in New York.

Meanwhile, gold supply from mines, which peaked in 2001, fell in five of the last eight years, data from London-based researcher GFMS show. Companies are digging deeper to extract dwindling reserves, with mines in South Africa extending as far as 2.35 miles into the earth.

Despite the recent runup, investors who bought at the historic peak are still waiting to break even. After adjusting for inflation, gold is at just half the level it reached in 1980, when the price rose to $850, equal to $2,266 today.
—Nicholas Larkin, Claudia Carpenter, and Millie Munshi

The bottom line *Uncertainty about global economic health is boosting the price of gold, even as the dollar strengthens and inflation remains tame.*

Development

The Real Estate Bust Hits Oman's Blue City

▸ The $20 billion project's fate is in the hands of bondholders

▸ "There are no buyers and those that did buy are no longer paying"

Blue City, a $20 billion real estate development, was supposed to help transform Oman, the Persian Gulf nation of about 3 million people. Government officials extolled the project as an important step in its plan to diversify the economy and prepare for the depletion of oil reserves. But Blue City, envisioned as a community for more than 200,000 people, missed sales targets as real estate speculators left Middle Eastern markets and a legal battle between the project's owners made potential buyers wary. Now it may face liquidation.

Oman, bordered by the United Arab Emirates, Saudi Arabia, and Yemen, has been ruled by Sultan Qaboos bin Said since he overthrew his father in 1970. Heavily dependent on dwindling oil reserves, it managed to boost production in 2009, according to the CIA World Factbook. It's not an OPEC member.

Blue City, an hour's drive from the capital, Muscat, was to be "a whole new city for the present and future generations," according to its website. The first phase would include more than 200 villas, 5,000 apartments, 4 hotels, 2 golf courses, and a clubhouse, according to the prospectus. A total of $925 million was raised from bondholders,

Quoted



"Sovereign-debt crises have been with us for many, many years. There is nothing intrinsic about such crises that they need to become important shocks to the broader, global macroeconomy."
—James Bullard, president of the Federal Reserve Bank of St. Louis

ABOVE: HENNER FRANKENFELD/BLOOMBERG; RIGHT: REUTERS

and construction started in 2006. Blue City turned down requests for interviews with its executives.

As of November 2009, sales of Blue City properties totaled $75 million, compared with a forecast of $860 million, according to Khalid Howladar, senior credit officer at Moody's Investors Service in Dubai. "The business model was to keep building with the purchase payments received," says Howladar. "Now there are no buyers and those that did buy are no longer paying, so there's no cash flow." Mohamed Ayjaz, general manager of Hamptons International in Oman, which was responsible for marketing the project from 2007 to mid-2009, said about 400 of the 5,000 properties on offer had been sold.

Today, idle yellow cranes hover above the skeletons of buildings with dark holes for windows. Security guards turned Bloomberg reporters away from the site, and one followed them to a nearby hotel.

Now Blue City's fate may be in the hands of its bondholders. Owners of $661.5 million worth of Blue City bonds are discussing measures to push the project ahead, a person familiar with the talks says. A vote on liquidating the project, proposed by holding company Al Sawadi Investment & Tourism, has been put on hold, the person says.

What happens next also depends on the outcome of a three-year legal battle between owners Cyclone in Oman and AAJ Holdings in Bahrain. Cyclone sued AAJ in September 2007, claiming the Bahraini company's purchase of a 70 percent stake in Blue City was invalid and the stake should be handed over to Cyclone. After a split decision in lower courts, the dispute is headed for the country's highest court.

"It's too early to say the project has failed," says Wael Lawati, chief executive officer of Omran, the investment arm of Oman's Ministry of Tourism, which says it is not involved in Blue City. He suggests that one possibility would be to shift its marketing focus away from wealthy foreigners. "In the past, Oman was only targeting the five-star-plus buyer in places like Britain and Germany," he says. "Now it's time to see what the Omani investor is looking for." ⓑ
—Zainab Fattah and Camilla Hall

The bottom line *Blue City joins the list of troubled real estate projects conceived when it looked like boom times would last forever.*

Bid & Ask



Art Market

Maxfield Parrish's 1922 *Daybreak* fetched **$5.2 million** at a Christie's auction in New York. The sellers were actor Mel Gibson and his ex-wife, Robyn, who filed for divorce last year. The price was well below the $7.6 million Robyn paid for the painting in 2006, which at the time established an auction record for a Parrish work.

Food

M-Foods Holdings is selling Michael Foods, a maker of specialty egg products and other dairy case products, to affiliates of GS Capital Partners, the private equity arm of Goldman Sachs. The approximately **$1.7 billion** deal is yet another sign that activity by private equity players is picking up after a two-year lull.

Pharmaceuticals

$3.7bn

Amount Abbott Laboratories is paying for the branded generics business of India's Piramal Healthcare. Under the terms of the deal, the Illinois-based drugmaker will pay **$2.12 billion** up front, plus **$400 million** a year for the next four years. The transaction will give Abbott 7 percent of India's drug market, plus a medicine chest of products to market in the U.S., where efforts to contain health-care costs are driving sales of generics.

Real Estate

$75mn

Asking price on a 90,000-square-foot Florida home with a 20-car garage, reports the *Orlando Sentinel*. The home, which features a 7,200-square-foot grand hall and a 30-foot-wide stained glass cupola is named Versailles, though unlike the French palace it boasts a bowling alley and roller skating rink. The colossus belongs to time share mogul David Siegel and his wife, Jacqueline, who are the parents of eight children. The broker with the listing, Coldwell Banker Residential Real Estate, says it has fielded inquiries from people around the world.

Finance

Hinduja Group, a conglomerate controlled by a pair of Indian billionaires, agreed to buy Luxembourg-based KBL European Private Bankers for **$1.7 billion** to expand its wealth management business in Europe. KBL has a presence in 10 European countries and close to $60 billion in assets under management.

$121k



Autos

An unrestored Aston Martin DB4 that was used for the James Bond movie *Goldfinger* and then languished in a barn for years sold for **$120,960** at an auction of vintage Aston Martins in England. The event, which was staged by Bonhams, raised a total of $6.8 million as collectors battled each other for the right to haul off gems from the 1950s and 1960s.

Collectibles

A 1794 so-called Liberty dollar in near-perfect condition sold for **$7.9 million,** according to the Associated Press. The previous record for a coin was the **$7.6 million** paid for a 1933 $20 gold piece. About 1,750 of the 1794 Liberty dollars were minted, but only 150 are still in existence. The coin was purchased by the Cardinal Collection Educational Foundation of Sunnyvale, Calif.



Commodities

$3.1bn

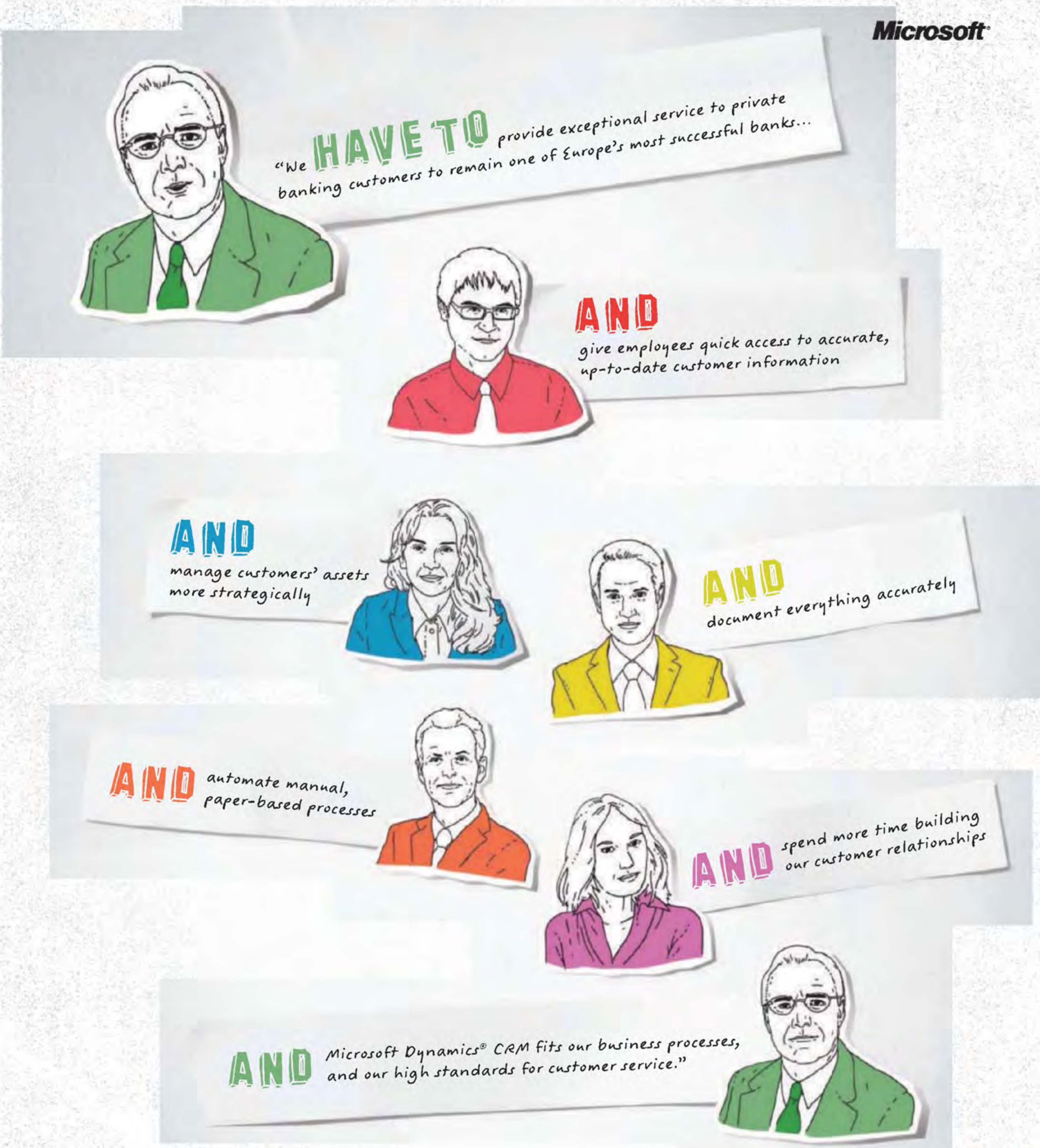
What Sinochem will pay Statoil for a 40 percent stake in Peregrino, a Brazilian offshore oil field. China's biggest chemicals trader and Norway's largest oil and natural gas company also announced that they will seek joint invesment opportunities in Brazil and elsewhere.

Technology

IBM is paying **$1.4 billion** for Sterling Commerce, an Ohio-based maker of software that helps businesses share information. IBM Chief Executive Officer Sam Palmisano has outlined plans to spend $20 billion on takeovers in the next five years.

IBM

FROM TOP: CHRISTIE'S/BLOOMBERG; BONHAMS/BLOOMBERG; RARE COIN WHOLESALERS/GETTY IMAGES



Microsoft Dynamics® CRM helps your employees stay closer to your customers by providing a consolidated view of account information at the push of a button. Better insight into client needs gives your people the right information at the right time to help them identify and capitalize on the right investment opportunities for your clients.

To learn more about the efficiencies Microsoft Dynamics CRM can create for your business, go to **microsoftdynamics.com/financialservices**

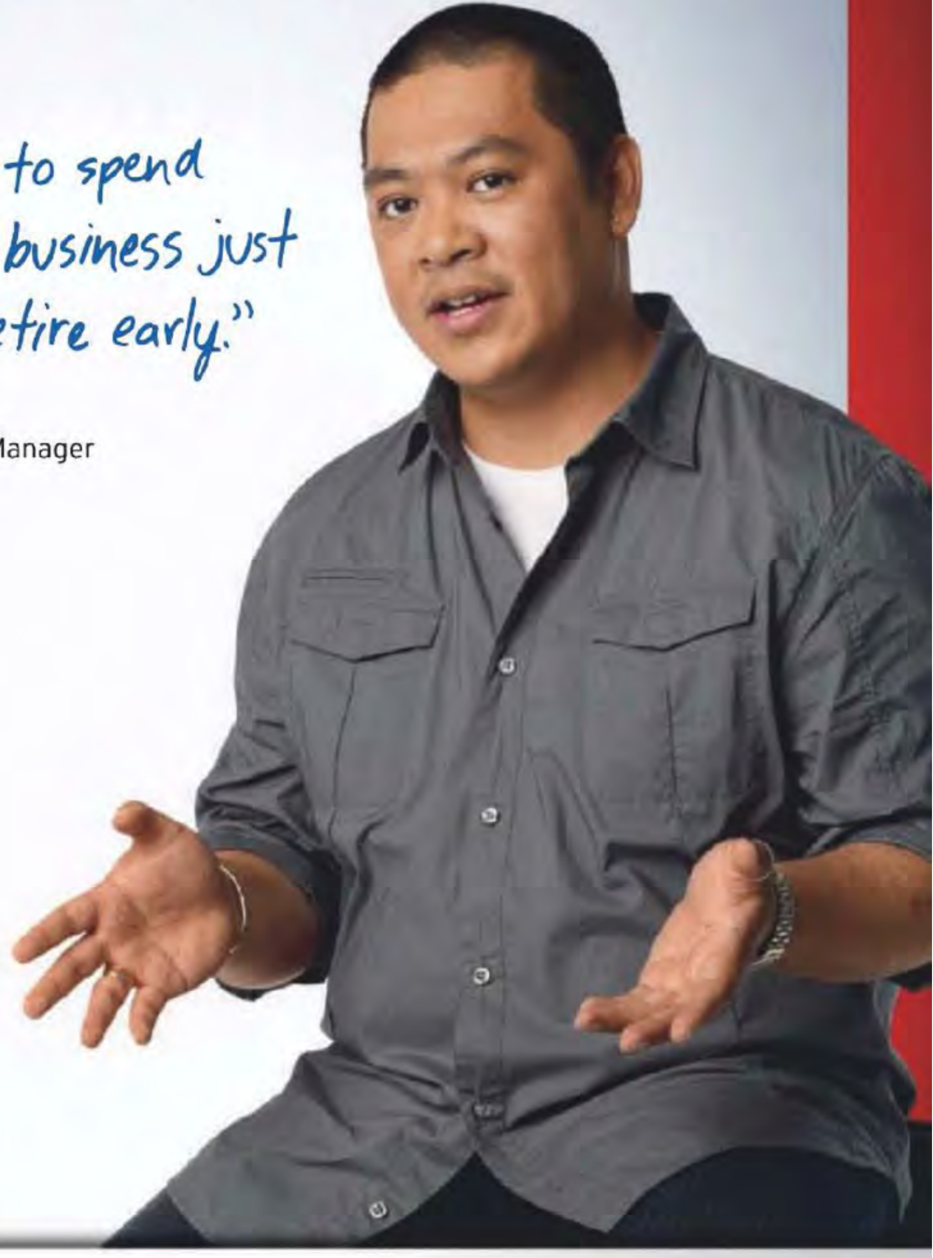
Microsoft Dynamics CRM

Because it's everybody's business

LAST YEAR ALONE CYBERCRIMINALS STOLE OVER $40 MILLION FROM SMALL BUSINESS BANK ACCOUNTS.*

"You don't want to spend years building your business just so a hacker can retire early."

Jamz Yaneza
Threat Research Manager
Trend Micro



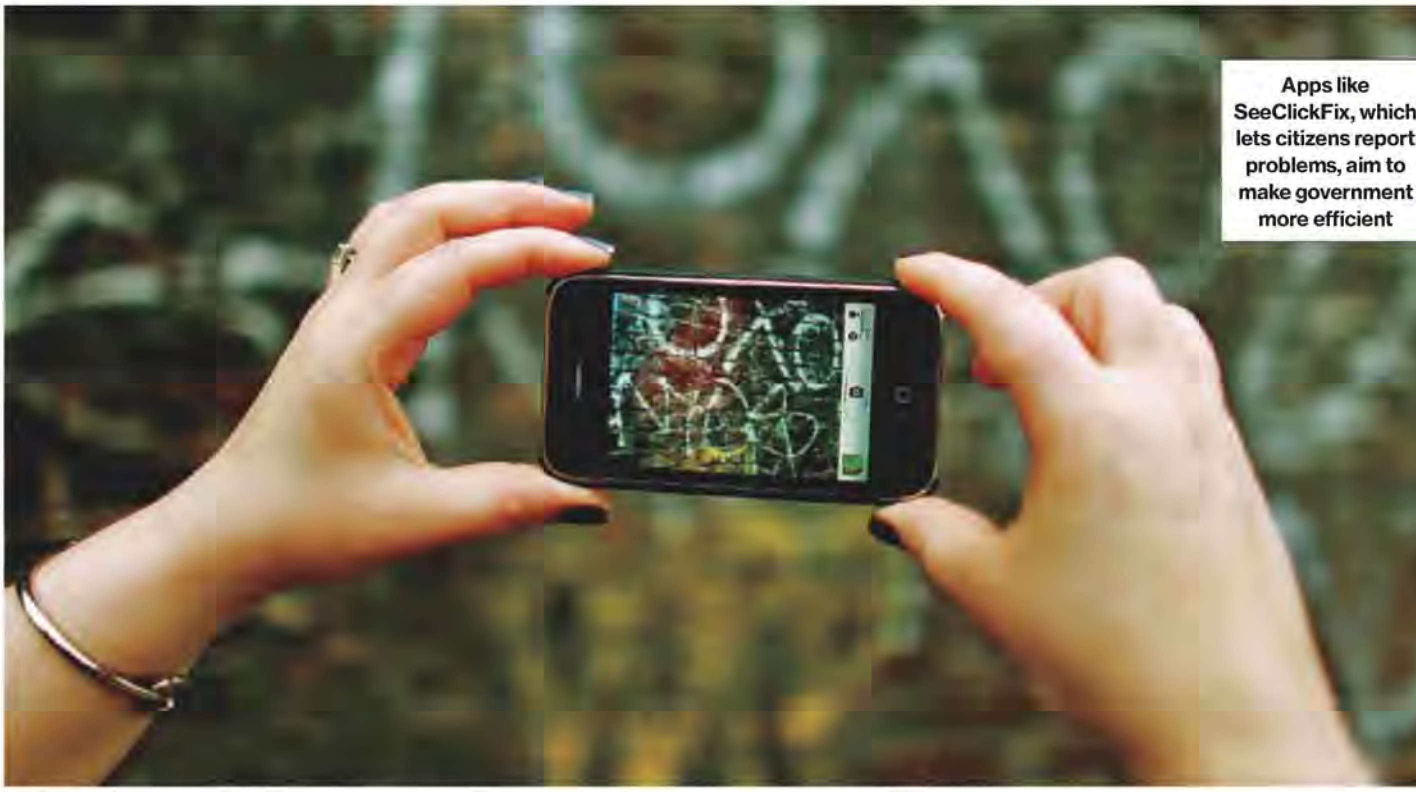
Like any good predator, cybercriminals go for the easy kill, and small businesses are a prime target. Using malicious software called *bots* hackers break into computers, steal banking pass codes, and drain cash from small business accounts before anyone notices. Many victims actually have an Internet security solution in place at the time of attack, but it just isn't good enough. Trend Micro's Worry-Free™ Business Security is different. It provides all-in-one protection that stops attacks like these before they reach you. You just set it and forget it. We do the rest.

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Focus On **Enterprise**



Apps like SeeClickFix, which lets citizens report problems, aim to make government more efficient

The Next Internet Boom: Dot-Gov Startups

▶ **Gov 2.0 entrepreneurs see profits in helping governments work better**

▶ **A contest produces apps "far better than anything the city could have offered"**

Kevin Merritt never intended to become a government contractor when he launched **Socrata,** an online service making it easy to share data—anything from crime statistics to football schedules. But early last year he noticed that federal agencies were the site's biggest users. "It became clear that a really good place for our technology was helping government organizations share data in the interest of transparency," says Merritt, a **Microsoft** veteran who lives near Seattle. Today the 14-employee startup has 20 government clients, including Medicare and the City of Seattle, some paying more than $5,000 a month.

Merritt is at the forefront of an emerging field that some entrepreneurs call Government 2.0. With the White House urging federal agencies to make statistical data and other information available to the public, the Internet's next big opportunity may be tapping that information to boost government transparency, efficiency, and responsiveness. Much as blogs and **YouTube** democratized media and **eBay** let anyone become a retailer, these entrepreneurs want to help citizens participate more directly in governing.

Tim O'Reilly, founder of technology publisher **O'Reilly Media,** likens the effort to Interstate highways, the global positioning system, and the Internet. Those public investments all unleashed private-sector innovation. Similarly, by giving everyone access to government data, "you don't have to do all the innovating yourself," says O'Reilly, who hosted a Gov 2.0 Expo in Washington, D.C., on May 25, one of at least 10 similar events held across the U.S. over the past year.

One way governments encourage innovation from entrepreneurs is through apps contests. These offer prize money to developers who build software applications using public data. New York, Washington, and Portland, Ore., have all started competitions. Federal agencies have sponsored efforts aimed at expanding broadband access and reducing childhood obesity. Even the Pentagon has gotten on board with an "Apps for the Army" challenge for soldiers. All told, more than 350 apps that tap into public data have been submitted to such contests, some of which are ongoing.

Lawrence Lenihan, managing director of New York venture firm **First-Mark Capital,** helped judge the New York apps competition—and

GRAEME ROBERTSON/GUARDIAN NEWS MEDIA

Charles Schwab: Don't bail out yet
page 58 ▶



then invested in one of the winners, a startup called **My City Way.** The company makes a smartphone app that helps users find restrooms, Wi-Fi hotspots, subway stations, and more, all based on city data first made available in October. "The types of applications that were created were far better than anything the city could have offered," Lenihan says.

Some entrepreneurs aren't waiting for government to open up. Instead, they're creating Web apps that help push officials and agencies to be more transparent and responsive. Ben Berkowitz and three co-founders created **SeeClickFix** as a way to report problems such as potholes and graffiti to the city government in New Haven, where Berkowitz lives. The site uses **Google** Maps to let people flag issues in their neighborhood and send notices to their local officials.

The company has licensed the tool to newspapers, TV stations, and other local news Web sites. So far, more than 400 have signed up. New Haven, Tucson, Washington, and other cities also pay to plug SeeClickFix into their own response systems, so complaints get routed directly to the appropriate agency. A total of more than 36,000 problems from cities and towns nationwide have been reported on the site, and 40 percent have been resolved, Berkowitz says. He calls Gov 2.0 a way of "redistributing governance to the hands of citizens."

Of course, plenty of public agencies resist openness, and startups that want to sell to or partner with the government often face frustrating bureaucracies. Yet even small steps by government, such as releasing public data, can create new business opportunities for entrepreneurs. Says O'Reilly: "This is one of those amazing outcomes where the government does something small that has a huge impact on the economy." —*John Tozzi*

The bottom line *Entrepreneurs are creating online businesses that make the government more transparent, efficient, and responsive.*

Advertising

The Race to Woo Main Street on the Web



▶ **Google, Bing, and a slew of startups boost their focus on small business**

▶ **"There's an increasing sense of urgency" about online marketing**

On the Internet, it's been said, nobody knows you're a dog. And if you happen to be a dog groomer? You're lucky if anyone even knows you exist. Fewer than half of all U.S. small businesses have websites or advertise on the Net, Nielsen Online reports, even though most consumers search online for local shops and services before picking up the phone or leaving the house.

Now, dog groomers, car detailers, and other neighborhood businesses have a host of new options for raising their profile online. Hundreds of new services have cropped up, aiming for a piece of the $17.5 billion that consultancy BIA/Kelsey says U.S. small businesses will spend on Net ads this year. By 2014, BIA estimates, that figure will grow to $36.7 billion, a quarter of all local advertising. "There's an increasing sense of urgency around having an effective online marketing strategy," says Court Cunningham, CEO of online ad agency **Yodle,** which caters to small businesses.

The biggest players on the Internet know there's money to be made serving small business. **Microsoft**'s Bing is shoring up neighborhood-specific information and business listings. "Local is a key area of focus," says Bing marketing chief Mike Nichols. **Yahoo!** on May 24 renewed a partnership with **Nokia** to power its maps and navigation services for local listings. On Apr. 20, **Google** rebranded an older small biz service called Local Business Center as Google Places. Google has created pages with data on millions of small businesses, and some 2 million companies have added their own information to those pages. Owners can also request a free photo shoot of their shop, and in 11 cities they can pay Google $25 a month to make their listing pop up with an icon and other information when consumers check neighborhood maps on smartphones and on the Web. "Our view is we're in early stages of the intersection of local and mobile," says Carter Maslan, Google's local search boss.

Smaller companies are aiming for the same market. Business directory **MerchantCircle** has online profiles of 1.3 million small companies, four times what it had two years ago. Review site **Yelp** had 31 million unique visitors in April, up 35 percent year-on-year, and on May 5, Yelp launched a French service. Dozens of sites offer coupons that small business owners can use to attract new customers. **Valpak**, which has long distributed local circulars by mail, in March launched new mobile apps. Chicago-based **Groupon** helps promote small businesses via daily e-mails with deals on products and services. Groupon operates in 65 cities across the U.S. and in April raised $135 million in venture capital. On May 16 it acquired **Citydeal**, a similar service based in Germany, expanding its presence to 18 countries.

Unsolicited Advice

Chris Guillebeau, small biz consultant and blogger

Last year I wrote 10,000 e-mails to people who joined my newsletter list. The message writing affects all metrics of my business—sales, visitor value, site comments. Maybe you don't want to send 10,000 e-mails. No problem. But are you delegating your customer contact? This is some of your most important work. If you wouldn't delegate strategy, why delegate relationship building? Don't cut off ties to your customers; make them closer.



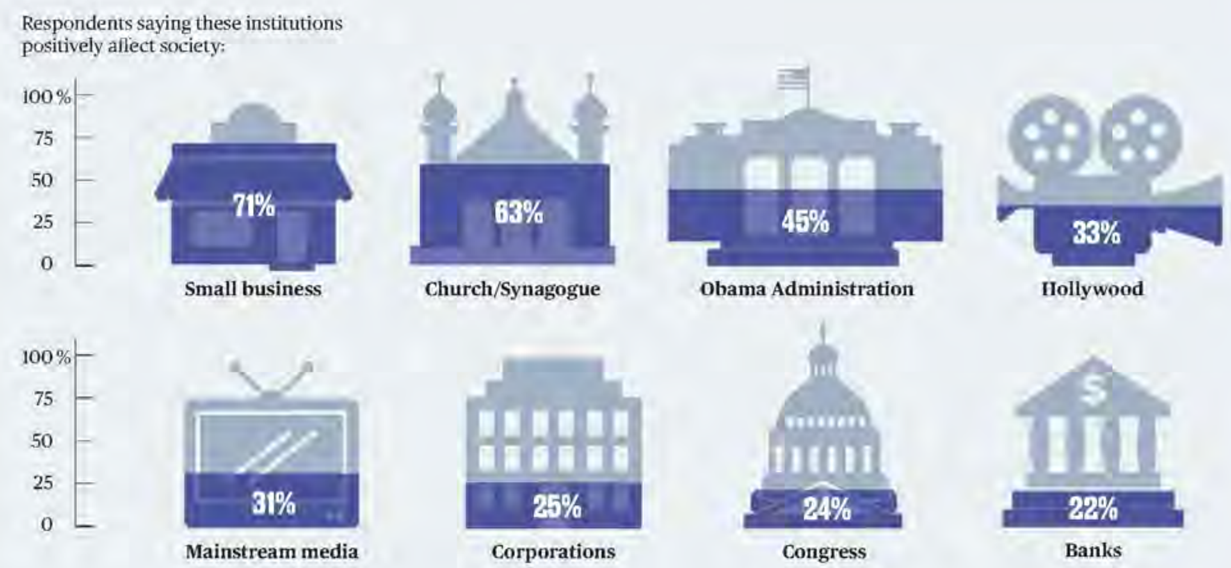
Guillebeau writes on travel and small business at UnconventionalGuides.com

FROM TOP: JUSTIN SULLIVAN/GETTY IMAGES; ILLUSTRATION BY TOPOS GRAPHICS; ILLUSTRATION BY ANDY FRIEDMAN

Opinion Poll

America's Most Trusted

A survey about public distrust of government asked whether certain institutions contribute to society. It turns out Americans trust their corner pizza parlor or nail salon more than Big Government, Big Business—or even Big Religion.



DATA: PEW RESEARCH CENTER STUDY OF 2,505 ADULTS CONDUCTED MAR. 11-21, 2010. MARGIN OF ERROR IS PLUS OR MINUS 2.5 PERCENTAGE POINTS.

The multitude of choices is spurring rapid growth in another category of online business: companies that sort through all the options and help small business owners figure out a Web strategy. Among the biggest is **ReachLocal,** based in Woodland Hills, Calif. The company raised $54 million in an initial public offering on May 20. Its revenues in 2009 grew by 38 percent, to $203 million, and this year it expects to introduce a tool that lets business owners monitor what's being said about them online. Rival **WebVisible** says its sales have grown by 100 percent annually for the past three years, and founder Kirsten Mangers plans to nearly double the headcount at the 285-person company by December. "There are 17,000 location-based apps" alone, Mangers says. "It's almost impossible for [business owners] to figure out. We're bringing order to the chaos." —*Nick Leiber*

The bottom line *Local businesses face an ever-growing range of options for promoting their products and services online.*

ILLUSTRATION BY MATT OWENS

Taxes

A Paperwork Nightmare For Small Business

- ▶ A clause buried in the health-care bill requires a flood of new filings
- ▶ It's justified "only if you assume nearly all businesses are cheaters"

Anyone who makes it to page 737 of the massive health-care bill approved by Congress in March will find a three-paragraph section that has nothing to do with hospitals, doctors, or drugs. The provision, inserted by Democrats on the Senate Finance Committee to help offset the cost of the bill, requires companies to report to the IRS payments of more than $600 a year to any vendor. The intent is noble: to capture $2 billion or more a year in taxes on income that currently goes unreported by contractors and small businesses.

Business advocates fear it could generate a flood of paperwork. While the provision affects all companies, small businesses will be slammed the hardest because they often lack the compliance departments and legions of accountants that corporations retain on staff.

Today, businesses must file 1099-MISC forms only for freelancers and other service providers that aren't incorporated. The form is meant to make sure these workers pay taxes that the business would withhold if they were regular employees. The new rule, set to take effect in 2012, will expand such reporting to include payments to companies, and for goods as well as services. That means businesses will need to get tax ID numbers and file forms for almost all suppliers—and track all their small expenses to see which vendors meet the threshold. Spend $600 on cell-phone service, at **FedEx,** or fueling up at the local gas station? Better get their tax ID number. Buy new computers? File a 1099. "It's going to be a compli-

Speed Dial

Getting Prices Right

Consultant Rafi Mohammed's *The Art of Pricing* is among the leading texts on the subject. Here he discusses pricing strategy for small business

Why do you think small businesses have seen profit margins shrink?
During the recession, companies of all sizes kept their prices low, which means either reducing costs or reducing margins. Small businesses had less flexibility to reduce their costs than big companies; they couldn't outsource as much, for example. So they opted to take the hit from the profit side.

There's lots of talk about "frugal fatigue." Is it time to raise prices?
Definitely. When things were really bad, consumers were in frugal mode. They're now feeling more confident. They're saying: "I'm tired of penny-pinching. It's time for me to go out and spend a little more." That's an incredible opportunity for businesses to increase prices and make higher margins.



How should companies frame a price increase?
The messaging is crucial, particularly for small businesses. It should be something along the lines of: "As you did, we tightened our belts during the recession. We're happy the recession is over. Our costs are going up, and we're going to have to pass on this price increase."

Your main strategy—setting prices based on perceived value instead of costs—seems like common sense.
Yes, but 90 percent of companies simply mark up costs. Pricing has always been confusing for companies. They continue to set prices based on "This is how we've done it over the years," not strategy. There's often a lack of confidence in the value of the product or service. Most people in the company, not just in sales or customer service, need to understand why they're in business, why the business is so interesting, and what the pitch is.

Pricing is about the value that the product offers relative to the next best alternative. If potential customers are using a rival's product, you need to justify why they should use yours. "Sure we offer fewer attributes, but we're cheaper." Or, "Gee, for only 15 percent more, you get all these attributes." When consumers buy a product, they're in essence saying, "I looked around at all of your alternatives, and you offered me the best value."

This also means changes for salespeople, doesn't it?
A lot of times the sales force is shooting in the dark in terms of what they're emphasizing. By better understanding the profit margins—and by being compensated on profits [as opposed to volume]—their financial interest aligns with the company's: making the most profitable sales it can. —*Nick Leiber*

ance nightmare," says Rob Seltzer, an accountant in Beverly Hills, Calif. He figures he would go from filing two 1099s to 15.

Seltzer is on the low end. The IRS says about 85 million 1099-MISC forms are filed each year, and that could jump significantly under the new law. The National Small Business Assn. estimates that the average company will have to file 95 of the forms under the measure, up from fewer than 20 today.

Representative Dan Lungren (R-Calif.), with the support of small business advocates, has introduced a bill to roll back the provision. He says it imposes extra costs on business owners who pay their taxes to help the government catch those who don't. "This paperwork burden is only justifiable if you assume that nearly all businesses are cheaters," says Lungren. The bill would force "every single businessperson to become an IRS agent." —*John Tozzi*

The bottom line *A provision of the new health-care bill requires companies to file tax forms for almost every supplier—a big burden on small businesses.*

Financing

IRS Scrutinizes 401(k) Cash for Small Biz

- A great way to fund a startup—if it doesn't violate tax rules
- "We are seeing problems ... it's open to abuse," says an IRS official

As the credit crisis has made it tougher for small businesses to get funding, some would-be entrepreneurs have exploited a loophole that lets them finance a startup with 401(k) retirement funds without facing any taxes or penalties. Now the technique is catching the attention of the IRS, which plans to step up audits of such transactions. "We are seeing problems," says Monika Templeman, acting director of employee plans at the IRS. "It is open to abuse."

The transactions typically require an entrepreneur to create a new corporation, establish a 401(k) plan for it, and move existing 401(k) funds into the plan. Money from the new 401(k) is used to buy shares in the new company, and that provides the business

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with capital while retaining the tax advantages of the 401(k). Without such a rollover, funds withdrawn from a 401(k) are subject to income taxes. A 10 percent penalty applies if the funds are withdrawn by a person under the age of 59½. Templeman says the IRS has seen questionable valuations for the new stock, and in a few cases the money was used to buy recreational vehicles and other personal assets.

While financial advisers began promoting such rollovers in the early 1990s, the credit crisis has made them more attractive. This year at least 4,000 people are likely to use the strategy, an increase over previous years, according to companies that help craft the plans. The typical transaction involves between $100,000 and $200,000 in retirement funds. Advisers charge about $5,000 for the paperwork, plus annual fees of at least $800 to run the new 401(k) plan. "When you start comparing it with a 15 to 20 percent interest rate on a loan ... people are saying 'I'd rather be my own investor,'" says Jeremy Ames, chief executive of Guidant Financial Group, a Seattle company that helps business owners roll over 401(k)s.

Ames and other advocates of the rollovers say their transactions are legal. That doesn't mean the IRS will see it that way. Stephen Dobrow, president of benefits consultancy Primark Benefits, says even plans the IRS has examined may face renewed scrutiny. The IRS, he says, "can still blow up those plans even though they've passed on them once." *—Amy Feldman*

The bottom line *Using 401(k) funds to finance startups got more popular during the recession, but some of the transactions may violate tax law.*

Quoted

"The best ideas come out of the corner of our eye, the edge of our consciousness, in a flash. They are the result of misdirection and random collisions, not a grinding corporate onslaught."
—Seth Godin, author and marketing expert



Economic Development

Urban Businesses: Adapting to Hard Times

▶ The Inner City 100 shows how companies can thrive in rough areas

▶ A New Orleans CEO: "We have faith the city is going to rebound"

Kenneth Purcell has called 911 about 20 times in the past year to report break-ins and other crimes near his office in New Orleans' Warehouse District. Nonetheless, **iSeatz**, Purcell's 25-employee software company, is staying put. As a New Orleans native, he thinks it's important for businesses to create jobs in rough neighborhoods. "We have faith the city is going to rebound," says Purcell, 35. "It's heading to a more stable, more secure place." ISeatz is thriving, with sales last year of $38 million, up from $28 million in 2008.

Purcell's company earned second place in this year's Inner City 100, a ranking of the fastest-growing urban businesses in the U.S. The annual roundup is compiled by the Initiative for a Competitive Inner City, a nonprofit founded in 1994 by Harvard Business School professor and competitiveness expert Michael Porter. The goal is to show that companies can gain a competitive edge by locating in urban areas, while at the same time benefiting local economies. Over the past dozen years, companies on the list have created 72,000 jobs in city centers.

These are no mom-and-pop operations. They are multimillion-dollar manufacturers (18 percent of the 2010 list), builders (13 percent), and tech services outfits (also 13 percent). About 85 percent of the companies on the list say sales will grow this year, with more than a quarter predicting expansion of at least 30 percent.

It helps that governments pump money into city centers. Nearly a third of this year's winners say government contracts are their primary source of revenue. **Total Team Construction Services** of West Sacramento, Calif., ranked No. 1 on the list, has done work for the Veterans Affairs Dept., the U.S. Air Force, and California counties.

Many companies on the list have adapted to hard times. **HDM Systems** (No. 9) once specialized in high-capacity batteries that power 18-wheelers when they're parked, to reduce idling. When the trucking industry collapsed last year, founder Aileen Liu shifted her focus to supplying defense contractors. **W Industries** (No. 24) sensed trouble among automakers early and began to diversify beyond car parts seven years ago. Today 90 percent of its business comes from defense contractors, aerospace companies, and others outside the auto industry. CEO Ed Walker, whose father established the business in 1981, now hopes to take advantage of Detroit's property bust and buy a new workshop for the 200 employees he plans to hire this year.

One purpose of the list is to persuade big companies to invest in inner cities as part of their normal operations, rather than through corporate social responsibility programs. On page 56, Harvard's Porter explains how corporations can help revitalize American cities–and boost profits–by purchasing services and supplies from small companies near their inner-city headquarters. *—Nick Leiber*

The bottom line *Companies are finding that they can prosper in impoverished city centers—though government contracts help.*

Urban Stars

The top 10 companies from the Inner City 100, ranked on growth over five years. For the full list, please visit **businessweek.com/small-business**

1. Total Team Construction Services
West Sacramento, Calif.
Contractor and construction manager for government agencies

2. iSeatz
New Orleans
Software for managing reservations and selling tickets online

3. Sensis
Los Angeles
Marketing services for companies targeting minorities and gays

4. Paniagua's Enterprises
Baltimore
Installs and maintains fiber-optic cable for cities and states

5. Emma
Nashville
E-mail marketing for small businesses and nonprofits

6. NewBath
New Orleans
Refinishes bathtubs and remodels home bathrooms in Louisiana and Texas

7. Aptera Software
Fort Wayne, Ind.
Software development, website design, and IT consulting

8. Premier Organics
Oakland, Calif.
Makes gourmet nut butters and coconut products

9. HDM Systems
Allston, Mass.
Designs batteries and power-saving devices for trucks and military vehicles

10. FutureNet Group
Detroit
Construction, civil engineering, and environmental consulting

DATA: INITIATIVE FOR A COMPETITIVE INNER CITY

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Michael Porter

Focus On Enterprise

How Big Business Can Help Itself By Helping Its Neighbors



Companies can go beyond corporate social responsibility programs and benefit their communities simply by doing more business close to home

A decade ago, Archie Williams, the founder of a small printer-toner distribution company in the impoverished Boston neighborhood of Roxbury, happened to play a round of golf with Tom Stemberg, the founder and then-chief executive of office supply mega-retailer Staples. Through 18 holes, the pair pitched, putted, and chatted–and became fast friends. Soon, Stemberg started buying printer cartridges from Williams' company, Roxbury Technology.

The deal turned out to be a win for both Staples and Roxbury–the company and the neighborhood. The office supply giant found a reliable supplier for an important product and Roxbury got a partner that could distribute its goods nationally. Stemberg soon became a mentor to Williams' company, helping with strategic planning, finance, and legal advice. Roxbury Technology is now a preferred supplier to Staples and has branched out into manufacturing. Last year it hit $16.7 million in revenue, up from $1.2 million in 2001. Even better for the community, almost all of Roxbury's 65 employees live in the neighborhood or nearby.

Staples is one of a handful of large organizations that have found a way to boost their competitiveness while also benefiting their local communities. Hospitals and universities, often located in city centers, do this. But all too often, large companies see corporate social responsibility as something entirely separate from their business goals. As high unemployment, rising poverty, and dismay over corporate greed breed contempt for the capitalist market system, companies would be wise to follow the lead of Staples. Serving the intersecting needs of business and the community is the only path to winning back respect for Corporate America.

Consider this: Nearly 20 percent of large and midcap companies in the Standard & Poor's 900 index are headquartered in disadvantaged urban areas. These companies are huge employers that purchase hundreds of billions of dollars in goods and services annually. But they ignore the impact they can have on the surrounding community and how their neighbors can affect their own productivity, hiring, customer base, and reputation. While almost all big companies have active charitable programs and give to social service organizations, they rarely grasp that helping revitalize their local communities can enhance their competitiveness.

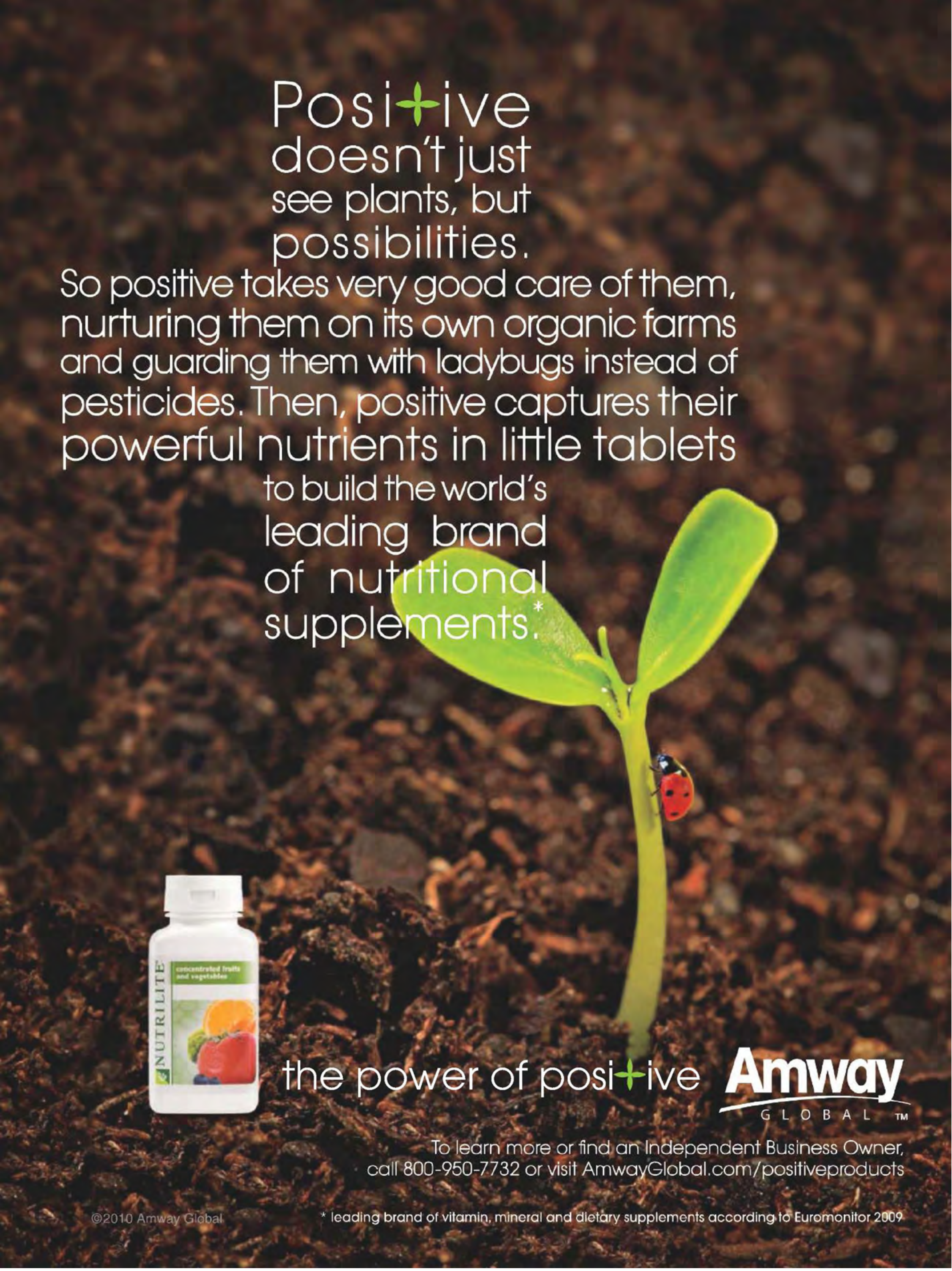
Such strategies should be based on the concept of shared value, practices that increase productivity while benefiting the community. We are seeing many more ways to create shared value, ranging from reducing pollution to improving the productivity (and wages) of low-income workers. Such efforts must be tied closely to a company's core business operations, where it can bring its skills and resources to bear.

Nowhere are the opportunities for creating shared value more apparent than in impoverished urban areas. Economic inequality raises fundamental challenges to capitalism, and inequality will not be solved until we help residents of disadvantaged communities prosper in the market system. Inner-city residents need jobs near their homes that offer good pay and the prospect of long-term employment. These can be created only by business.

Corporations can, in turn, jump-start the real job generators in the inner city: small businesses. Enterprises with fewer than 100 employees create 60 percent of the jobs in the U.S., and the ratio is even higher in disadvantaged communities, according to data from the Initiative for a Competitive Inner City. Small businesses create wealth for both employees and owners, and those in disadvantaged areas hire disproportionately from the local community; 40 percent of the employees of the companies on the 2010 Inner City 100 list reside in nearby neighborhoods. Entrepreneurship is thriving in America's inner cities, but we need many more such businesses to hire residents and revitalize their communities. Major corporations can play a huge role in this process by sourcing from these pioneers.

Businesses acting as businesses, not as charitable givers, are arguably the most powerful force for addressing the issues facing our society. Companies, if animated by the principle of shared value, can drive the next wave of innovation and productivity in the U.S. Such efforts will give purpose to capitalism and represent our best chance to legitimize business again. Ⓑ

Porter is a professor at Harvard Business School.


Posi+ive
doesn't just
see plants, but
possibilities.
So positive takes very good care of them,
nurturing them on its own organic farms
and guarding them with ladybugs instead of
pesticides. Then, positive captures their
powerful nutrients in little tablets
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leading brand
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Chuck Schwab Is Worried About The Small Investor.

[redacted]

Does That Mean We Should Be Worried Too?

[redacted]

"People are still in a state of fear," says the father of individual investing. "And with good reason." Schwab believes it is crucial for the little guy to stay invested. And his business depends on it

[redacted]

By Betsy Morris





In 12 years as a retail financial consultant for Charles Schwab, George Pennock thought he had seen every kind of market. Then, on May 6, he and his 250 clients lived through something new. Pennock was in Schwab's office in Englewood, Colo., just outside of Denver, talking by phone with a retiree who moved his money to Schwab last year because he says he felt suckered by his old broker. While they spoke, Pennock kept an eye on his computer screen and saw the Dow drop 250 points, bounce sideways, then go into free fall–300, 400, 900 points down. His client was watching the same thing on CNBC.

"What's going on, George?" the retiree asked. "Do you have any explanation for this?" Pennock didn't. He was thinking he should end the call and contact clients who had pulled out of equities after getting clobbered in 2008 and 2009. Some left at the bottom, then sat on the sidelines while the market raced up 80 percent. Maybe they would see this as a buying opportunity.

He never got the chance. In minutes, the market anomaly was over and the Dow was heading back up. It wasn't until the next day that Pennock, 37, began to appreciate its impact on investor psychology. He arrived at his office the morning after to find 22 phone messages. By day's end he had 50–one-fifth of his client base. "A lot of the calls were nervous," he recalls. "It was, 'George, this is testing my risk tolerance.' They have deep-seated concerns that [the correction] will go on for a while and nobody knows how long or how bad it will be."

It took Pennock two weeks to catch up on all the calls. "These conversations are lengthy," he says. "They take a lot of hand-holding." Some clients wanted to retreat; he reminded them why they had made financial plans in the first place. A retired airline pilot wanted to know if the 30 percent of his assets invested in equities was too high. (Pennock assured him it wasn't.) Another investor, who had waited five months to get back into the market, worried he had missed his chance. Most simply wanted reassurance. The May 6 crash may have been a freak occurrence, but it felt like one more sign that the deck was stacked against the little guy. "They got burned very badly before," Pennock says, "and they don't ever want to be in that situation again."

Many small investors had only begun to tiptoe back into equi-ties when the May 6 crash and the European credit crisis rocked the markets, completing a particularly cruel cycle. In the year prior–while the S&P 500 was rebounding 69 percent from its Mar. 9, 2009, bottom–individual investors withdrew a total of $11.5 billion from U.S. equity mutual funds and poured $506 billion into lower-yielding bond funds, according to TrimTabs Investment Research. By late spring, they had just begun to reverse course, venturing back into equities by channelling $13.9 billion into domestic mutual and ETF funds in March and $6.9 billion in April. By the third week of May, they'd withdrawn $29.3 million from U.S. equity mutual funds and poured an additional $8.2 billion into bonds. An American Association of Individual Investors survey taken the week of the May crash showed investor sentiment jumped to 36 percent "bearish," from 28 percent the week before. As of May 10, according to the Federal Reserve, money on the sidelines in bank and money market accounts had reached $9.36 trillion, compared to $7.44 trillion in May 2007.


Pennock with Schwab clients. He heard from 50 after the May crash

The period since early 2008 "is the worst time since I began the company," says Charles Schwab, the father of the modern American individual investor. "These are the most violent markets. Most people are still in a state of fear. I'd say 98 percent are still very concerned. And for a lot of good reasons. Look at the headlines. You've got these scoundrels doing all this stuff. People wonder, 'Who can I trust?' "

Schwab is sitting in his San Francisco office–which has always been spare but these days seems downright spartan–looking out the window at the Bay Bridge and mulling the tortured psychology of the American investor. "Where are they?" he asks, then pauses and lets out a sigh. "This is the most violent period I've ever seen," he says finally. "It was the end of capitalism as we knew it. The whole definition of safety and soundness–what does it really mean any more?"

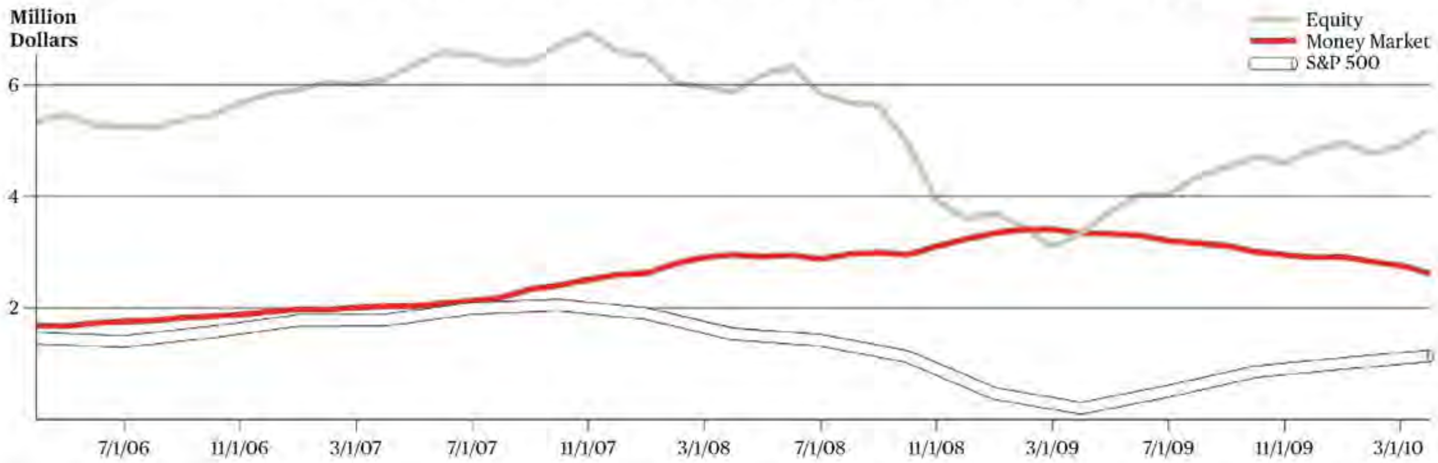
As chairman of the $4.2 billion company he founded in 1975, Schwab has reason to be worried about his customers. The success of his company depends in some measure on his financial advisers' ability to keep their clients engaged in the markets. Last year, almost a quarter of the company's revenue came from trading commissions; another 45 percent came from asset management fees. That's the tension at the heart of Schwab's enterprise. He has become the de facto therapist to the individual investor, but he is not a disinterested observer. His job–like Pennock and his other 6,868 licensed brokers–is to keep America invested. Schwab says that staying broadly diversified and firmly in the game remains the key to long-term financial security. Given what's going on in the world, should anyone believe him?

Schwab, now 72, and Vanguard Funds founder Jack Bogle are the old lions of the retail investment industry. Both played key roles in launching the Golden Age of individual investing–the period between August 1982 and March 2000 when the S&P 500 climbed from 102 to 1,527 and buy-and-hold seemed the surest path to security. Bogle was the pioneer of mutual funds and Schwab opened the door to equity trades for small investors. When Congress deregulated brokerage fees in 1975, some brokerage houses responded by raising fees; Schwab slashed his, making investing affordable for the middle class and becoming broker to the masses. His company's revenues grew from $387 million in 1990 to $5.8 billion in 2000. By then, it was offering round-the-clock trading, sophisticated investment analysis, and a mutual fund supermarket. Long before Starbucks, Schwab's branches were gathering places for market enthusiasts–office workers, day traders, and loiterers who

PREVIOUS SPREAD: JUSTIN SULLIVAN/GETTY IMAGES; THIS PAGE: PHOTOGRAPH BY KEVIN MOLONEY FOR BLOOMBERG BUSINESSWEEK

Market Timing

Institutional investors, dominant in equities, buy the dips. The little guy often flees



DATA: INVESTMENT COMPANY INSTITUTE

stopped by to check stock quotes, mull their next move, brag about their big scores, and indulge in a group fantasy about a spectacular new way to get rich.

As individual investing became a way of life, Schwab inevitably drew competitors–rival discount brokers (and, later, discount online brokers) such as Ameritrade and E*Trade, and full-service houses such as Fidelity. Schwab's company rode the late-1990s tech boom but was battered by the steep drop in trading following the 2000 crash. Schwab himself moved out of the top job in 2003, only to move back in a year later, renewing the company's commitment to the small investor. (Today the chief executive officer is Walt Bettinger.) During the financial panic of 2008, Schwab attracted investors fleeing Merrill Lynch, Wachovia, E*Trade, and other battered firms. That new business helped boost Schwab's assets under management 25 percent to $1.4 trillion last year from the prior year (compared with $1.5 trillion at Fidelity, $350 billion at TD Ameritrade, and $162 billion at E*Trade) but Schwab's revenue fell 19 percent under pressure from low interest rates. The company's stock was trading around $16 last week, down $3 from one month before.

Since 1986, Schwab has written four books on investing. He is an optimist by nature, one who has always preached asset allocation, diversification, and investing for the long term. By empowering individual investors at the start of the bull market, he and Bogle and Fidelity's marquee investor Peter Lynch inadvertently created a monster. As playing the market became a national pastime, investing turned into a synonym for stock-picking. Equities were thought of as savings. Today, legions of investors are torn between a newfound desire for safety and the allure of old, bad habits.

"It was the end of capitalism as we knew it," says Schwab. "The whole definition of safety and soundness—what does it really mean anymore?"

Worse, as Americans became do-it-yourselfers and sometimes day traders, their success–especially during the inflating of the dot-com and real estate bubbles–masked a profound shift in the balance of power. Wealth was migrating to institutions, hedge funds, and investment banks like Goldman Sachs, which had created proprietary desks to trade ever more esoteric instruments for their own accounts. Institutional investors now own about 70 percent of American corporations, up from 35 percent in 1975, according to Bogle. As trading algorithms grew more complex and computers sped up, every advantage went to the big guys.

The Yale School of Management has conducted a "buy on dips" survey since 1989, a confidence index that measures investors' willingness to buy after market drops of 3 percent or more. Institutional and individual investor sentiment tracked closely until 2007. At the height of the Dow Jones industrial average, in October 2007, 61 percent of each group said they would buy on dips. Since then they have diverged. By March 2010, 71.6 percent of institutional investors were willing to buy on dips compared to only 57.5 percent of individuals.

In other words, small investors need more help than ever. "Before, nobody needed advice–most just called me up to place their trades," says Robinson Martin, a financial consultant in Schwab's Cobb County (Ga.) office, on the outskirts of Atlanta. Now Martin and others are no longer cheerleaders and trade executors; they are psychologists, trauma experts, counselors, empathizers. It's a delicate balance. In pre-crash days, the company's clients were mostly avid investors. Rarely did Schwab have to coax them into the market. But that's what the company has to do now to prop up the assets it oversees. It's what it has to do to juice its own adviser business. It's what Charles Schwab has preached from the beginning–asset allocation over time. And it's what he does, as well. In August 2007, near the very top, he invested the more

than $10 million he'd received from the company's sale of its U.S. Trust unit in a portfolio divided between 50 asset classes. Then he left it. After losing about 30 percent of its value at its lowest point, it is now down about 12 percent, he says. "I follow my own advice," he says. "I'm not running for the hills. Yes, those investments might be somewhat down from '07, but they will be at higher values next year or the year after. I don't know exactly when, but I believe it because of my confidence in the American economic system. If you don't have that confidence, then you definitely should not be a client of Schwab."

Atlanta is a buy-and-hold town, loyal to local favorites Coke, SunTrust Bank, Delta Air Lines, and Home Depot, says Martin, 38, as he prepares to conduct a client seminar on a sunny weekday at Schwab's Cobb branch. The old rules don't work any more, he says. You can't buy and hold anything with confidence, and that's rattling even those who didn't follow the rules during the bull market.

Martin's conference room, inside a tall, glass-and-steel building in a suburban office park, feels like a relic of more prosperous times as a dozen strangers unwrap turkey and ham sandwiches and start talking about the markets. Most are retirees; three are doctors, one a former restaurant owner. They have come to get a market outlook that turns out to be cautiously optimistic. No matter. For nearly two hours, the conversation ricochets from one fear to another—mostly about what could blindside them next. Fannie and Freddie? Inflation? Government spending debasing currencies? "I look at what's happening in Greece, and I see us. I think that could happen here," says James Wood, an Atlanta neurosurgeon.

No one at the conference table knows what to believe anymore, and with good reason. "I had absolutely no idea how deeply the subprime mortgages had penetrated into the financial markets," says Dyckman Poland, a retired engineer. How are investors supposed to make informed decisions when they can't trust what's printed on corporate balance sheets, asks Dr. Wood. How much of the market is ruled by computer-generated trading anyway, another asks, "while you and I are just putting in our dribs and drabs? How do we individuals fit into all this?" Bob Bonacci, the vice-president of a business-services firm in nearby Kennesaw, looks around the table. "I think the majority of us are at or near retirement," he says. "We've taken a hit once, and now it looks like we're on the brink of another situation where it could all be taken away from us. For us, these mistakes are really going to count."

As the stock market fell toward the bottom in March 2009, Schwab distributed videos to its clients in which the founder tried to strike a reassuring tone. Just hang on, he urged. "We told them," Schwab says, "the world was not coming to an end." Yet just as they had after every market crash since 1987, investors fled to safety at the wrong moment, trading equities for cash and fixed income. "It is too darned bad," Schwab says. "So many people held on and held on and held on through 2008, and finally, by early 2009, they'd had enough. Then just at the wrong moment, they got to the pitch of emotion and they

Riding the Rapids

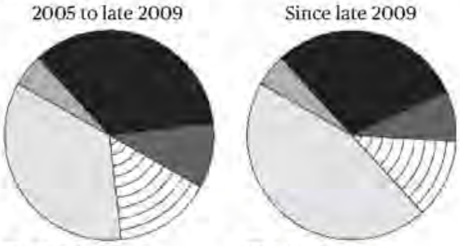
How three Schwab clients fared, 2006-2010*

Nº. 1

Investor: 61-year-old retired man†

Allocation:

2005 to late 2009 | Since late 2009



- **35%** large-cap
- **10%** small-cap
- **15%** international
- **35%** fixed-income
- **5%** cash

(Since late 2009)

- **30%** large-cap
- **8%** small-cap
- **12%** international
- **45%** fixed-income
- **5%** cash

†managed by Schwab

Nº. 2

Investor: a small-business profit-sharing account††

Allocation:

2005 to late 2009



25% Canadian oil trusts
10% oil exploration companies
5% uranium mining
60% other metals stocks

- **70%** equity
- **30%** cash CDs

no bonds

Net gains:
2005: 27%
2006: 29%
2007: 36%
2008: (58%)
2009: 105%

††not managed by Schwab

Nº. 3

Investor: 41-year-old small businessman††

Allocation:

nonretirement | retirement



(nonretirement)

- **100%** equity

2007 peak: $60K
Early 2009 low: $35K
Current: $40K

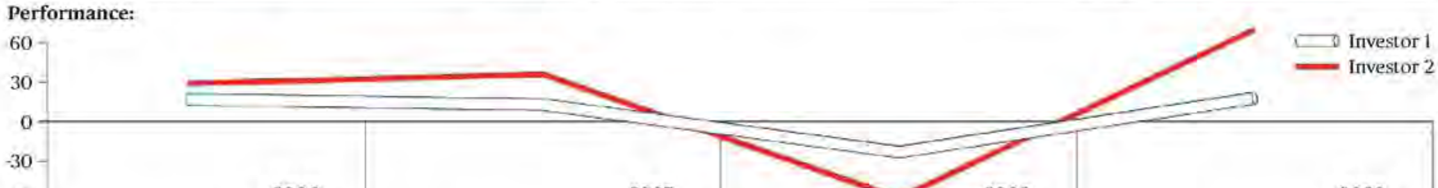
(retirement)

- **95%** equity
- **5%** cash

2007 peak: $50K
Early 2009 low: $30K
Current: $35K

††not managed by Schwab

Performance:



*Three randomly chosen Schwab clients in Georgia agreed to share their portfolio returns. No. 3 would only give estimates; his performance was not graphed.


Going up: Schwab in February 1987, five years into the longest of all U.S. bulls, as he helped define the Age of the American Investor

PAUL SAKUMA/AP IMAGES

said, 'I've had enough.' and chucked it in and sold. Fear took over in the most extreme way." To steady their nerves, the company puts out books, seminars, articles, and the famous "Talk to Chuck" ads. "One of our chief roles is to try to help people through this thing," he says. "But we can't help people overcome the power of fear. Or the power of greed. Those are too much a part of human instinct. We are not psychiatrists."

Now, Schwab says, his biggest worry is that investors will miss out again. They have $2.98 trillion stashed in money market funds, according to TrimTabs, and lots more in CDs and savings accounts. "If you're not an investor, you get no return on your savings and you have this very difficult situation coming up in the next three to five years of inflation that will just take away whatever you might get in some kind of yield. My fear is that inflation will come back and people will throw up their hands and say: 'Jeez, I wish I'd done something to protect myself.' "

That may sound self-serving. Except that, barring a return to a raging bull market, Schwab stands to benefit more, at least in the short-term, if its clients stay paralyzed. If interest rates take off, as the company expects they will by next year, its earnings will soar. That's because Schwab began to change its business mix a decade ago. Foreseeing an end to the bull market and with it, a decline in trading volume, it reduced its dependence on trading to 24 percent of total revenue last year from about 40 percent in 2000. It increased its asset management business and added the Charles Schwab Bank, offering retail banking and mortgage services—thus turning itself into more of a discount investor-services firm than a mere brokerage. It derives much more of its revenue from fees for managing and administering assets (45 percent last year, vs. 27 percent in 2000) and net interest revenue from the cash in its bank and money market funds (29 percent last year, vs. 22 percent in 2000).

If Schwab had not waived the fees it charged on money market funds last year—a move Schwab ordered because their interest yield was so low—trading would have accounted for just 20 percent of last year's revenue and interest would have accounted for 32 percent. And if interest rates do head higher, a report by JPMorgan Chase analyst Kenneth B. Worthington said this month, Schwab's earnings will react like a "coiled spring." As rates rise from 2010 to 2012, he predicts, Schwab's net income will more than double.

"We make little bits of money on everything, for the most part," says Schwab. "We are completely neutral about what you do. We would probably make more money on money that sits in a money market fund than on a stock you buy and hold. But we don't have an agenda. We really don't."

Yet the Schwab brand is not about making a killing by collecting interest on the money that clients have sitting in their accounts. The brand lives and dies by "Ask Chuck," as a place where befuddled investors go to *not* get screwed. And Schwab can't continue to be the "Trusted Advisor" if the client assets of its advisory business aren't growing. It's got to show that it's helping investors, and that means guiding them into vehicles that show growth, not stagnation. "Individual investors must understand asset allocation," says Schwab. "With just a few thousand dollars, you can get a little slice of this and a little slice of that—large caps, small caps, emerging markets, and then build on it," he says. The point is not to get in on the ground floor of the next Google and ride a juggernaut. "You're going to get maybe 5 to 10 percent per annum over 5 to 20 years—maybe 30. That's still pretty good."

The day after the Schwab seminar in Atlanta, one of its attendees, Gene Perkins, 66, returned to Robinson Martin's office. Though he has done his own investing since he sold his restaurant business three years ago, Perkins is now enlisting Schwab so he doesn't get burned, as he did in the 2008 crash when his investments lost 28 percent of their value. He and Martin are working on an asset allocation plan, and it's pretty tough going. Perkins' approach to investing is practically bipolar. At first, he presses Martin about the safest assets. "So what if you just buy treasuries and CDs?" Perkins asks. "Would it kill me to lose a little ground [to inflation] if it lets me sleep at night? It's all relative."

Within minutes, Perkins is trying to elicit a little stockpicking from Martin. That hybrid approach was a big winner during the long bull market. Even disciplined investors could dip in now and then, roll the dice and maybe make a windfall. "You're going to be mad at me for bringing this up," Perkins says. "But if the market tanks, there's going to be some good buys .... Let's say the market closes down 80 ... I may be wrong, dead wrong, and I hope I am. But I got eight or nine stocks here ...." He gestures to a hand-scrawled list: McDonald's, BP, Altria, Citi. He's got good arguments for each. "McDonald's is at $68–that's my business. If I can get it at $65, that's a good deal. And Citi ... I can wait it out. If Citi is still at $4 a share four years from today, well then I deserve to lose money on that account."

Martin listens patiently and then shakes his head. "Gene, that's too much risk," he says. What will Perkins do with the gains? "Keep it in cash?" Perkins ventures. "Or wait till the market tanks again and buy some more deals?" Responds Martin: "Gene, that's head fakes. When the market tanks again, you will pull everything out. You are playing Vegas odds."

Perkins slumps back in his chair. "I just have a lot to make up. I can't afford to take another hit."

Martin continues calmly: "You said McDonald's and Citi, Gene, and that may well be. But what you're missing is a hedge. Asset allocation is your hedge. You started this conversation with capital preservation, and what capital preservation has to be is a balance between risk and growth. Ultimately what we're trying to do is get out of the guessing game."

Martin keeps trying, his bedside manner patient but firm. Once Perkins has a plan in place, his assets will be invested broadly across asset classes to mitigate his risk. What he has to decide is the balance between risk and reward. With a financial plan working for him, "it's all math at that point," explains Martin. The hard part for so many investors is having to constantly recalibrate the portfolio to keep the asset classes in line with each other. That means scaling back on–not rushing into–sectors that are growing fast. To individual investors who came of age in a bull market, it's all painfully counterintuitive.

Perkins has heard it all before. "Asset allocation is the opposite of market timing, I do understand that," he sighs. "You all have made that crystal clear." And then he gets to the heart of the matter, the reason these investing decisions are causing him so much agony. He has no heirs. He will begin drawing on his retirement funds at 70. "If I live to be 90 ... if I start drawing at 70, will there be enough?" The subprime crash was a huge setback, and now he doesn't know. "I don't need to have anything left over. I'd like to be broke when I'm dead. I don't even need a casket. As long as I have enough. I just don't want to run out before I die." B

Commentary Roben Farzad

The Sun Also Sets

Investors learned the lessons of the recent recovery a bit too well

Who could blame an investor today for feeling a tad nostalgic for the Panic of 2008? There was a simplicity to the thing. It was such a brutal and impartial rout–slaying just about every asset class–that it made you want to swear off all markets forever. There was comfort to be found in stashing a shoebox full of $50 bills in the freezer. No paperwork. No jabberwocky from your broker. Just the reassuring face of Ulysses S. Grant juxtaposed with your cold, raw fear.

By March 2009, with U.S. stocks at 1996 levels, equities had returned less than Treasuries over the previous 10-, 20-, and 30-year periods–debunking the equity-risk premium so central to Econ 101. Until, of course, the market reversed course and surged 80 percent in 13 months, reminding investors that it was at least theoretically possible to make money in equities. That change of mood edged out fear just in time for the 2010 edition of the credit crisis, an international production that began with Greece's near-collapse and soon spread to Portugal, Ireland, Italy, Spain, and beyond. The Standard & Poor's 500-stock index has now fallen 12 percent in a month, its first official correction since the new bull began last spring.

Corrections are routine and even healthy events; they come along about once every 11 months on average and wring out the excesses and false expectations that rallies inevitably bring. "To the extent that current worries squeeze long positions, extinguish optimism, or even lead policymakers to pursue courses of action that are more supportive–not more punitive–for markets, the selloff may be creating more favorable entry points for investors to buy into a still recovering global economy," writes Stuart Schweitzer, global markets strategist for JPMorgan Private Bank, in a May 24 note to clients. That may all turn out to be true–provided investors don't panic, rush for the exits, and help turn a routine recovery into the second leg of a double-dip recession.

If the lesson of March 2009 is that the sun comes up–the most brutal selloff is just a prelude to the next rally–then the lesson of the recent runup is that the sun can shine too brightly, blinding us to boulders in the road. And then it can set.

With payrolls still slack and credit still tight, the contours of these peculiar economic times are becoming apparent. Last year's snapback is not going to bring a garden-variety, V-shaped recovery. Instead, investors are again having to confront the messy unfolding of a long and overly generous credit cycle, global in nature and marked by a spate of bank and business failures. How the economies of the world digest it is anyone's guess. When the next leg up begins, though, it will mark a critical milestone for a stock market that still needs to rally by almost half to revisit its 2007 high. Getting there despite profound economic challenges is going to take some hard traveling.

"In the U.S., we have no living precedent for this," says

Donald Luskin, chief investment officer at strategy firm Trend Macrolytics, whose search for domestic parallels to this credit crisis took him all the way back to 1907. "We have had a living laboratory for it in Japan for the past 15 years. But in the U.S., we're all attuned to the little upticks in metrics that don't necessarily inform much." In other words, we seek auguries where there are none by comparing traditional business cycle statistics such as payrolls and housing starts to once-in-a-lifetime lows from late 2008 and early 2009. Luskin predicts the market will be range-bound for at least five more years as companies and consumers shed debt. "This is not a particularly bearish view," he says. "It's just the expansion-less, low-return world we're now in."

Luskin's unenthusiastic outlook—which contrasts with the prevailing optimism among Wall Street strategists in a May 25 Bloomberg survey—brings to mind the "new normal" paradigm coined last year by Bill Gross and Mohamed El-Erian at Pimco, the bond giant. The idea is that a bitter confluence of deleveraging and reduced consumption and employment will necessarily bring a long period of low growth and low returns. In the absence of a healthy consumer, the neo-normalists point out, there is no other driver to magically propel the economy.

All of which is reasonable—and has largely been ignored amid a recent rush to riskier, less stable sectors at the expense of large-cap companies. This rush was less than rational; if returns are negligible and credit is tight, one would have expected investors to move into big, stable equities that pay dividends. But they didn't, even though the private equity feeding frenzy and promiscuous lending that made small-cap company buyouts all the rage a few years back are long gone. Small companies today are less likely to be self-financed and far more likely to be dependent on volatile-rate bank debt (assuming it is offered to them at all). Even so, the S&P's small-cap index has returned 3.6 percent so far this year—almost 10 points better than the 5.8 percent loss registered by the S&P 100 (the bluest of blue chips, including IBM and ExxonMobil). Going back to the market's low last spring, the excess return is hardly inconsequential: 90 percent for small stocks, vs. 50 percent for the mega-caps.

The Volatility Index Spikes Again

The risk premium has returned to crisis levels. Only the cataclysmic fall of 2008 remains in a class by itself



The lesson? The financial conflagrations of the past three years did not signal a permanent flight to quality. Appetite for the high-risk/high-reward trade is alive if not well. The resurgence of large-cap equities has, again and again, been exaggerated. According to Leuthold, a Minneapolis fund management firm, small-cap stocks now sell at a "very fat" valuation premium of 20 percent relative to large caps, an all-time record disparity. Nobody seems to care that Johnson & Johnson, with a $165 billion market cap and impeccable financials, pays a 3.62 percent dividend—more than 10-year Treasuries. AT&T, the country's largest phone company, an inveterate booster of its dividend over 26 years, yields almost twice that, but its shares have badly lagged the broader market this year. All this as banks believe they are doing you a favor by advertising 1 percent for your cash.

To some, any case for U.S. stocks—small, large, whatever—is also exaggerated. Pimco is now lumping the U.S. together with Japan, France, Spain, and Greece in what it calls a sovereign debt risk "ring of fire"—an ignominious league of nations that will increasingly have problems paying their debts. That association would suggest a lot more downside for U.S. shares, whose aggregate 4 percent drop so far in 2010 is but a sliver compared with the S&P Euro Index's 12.5 percent plunge.

Everywhere you look in the U.S. and Europe is another investing dead end. Together, they make the case for aggressive allocation away from developed markets and into emerging markets—yesteryear's financial basket cases turned today's paragons of growth. According to the International Monetary Fund, the developing world has catapulted itself from 18 percent of global GDP in 1994 to 31 percent last year, with its share still gaining at the expense of Japan, Western Europe, and the U.S.

That sort of growth means it is now far too prudish to allocate a mere 10 percent of one's portfolio to developing powers such as Brazil and India. "U.S. investors should move from a U.S.-centric worldview and toward a larger allocation to emerging market economies," says John West of Research Affiliates, an index strategy shop, also of Newport Beach. "They don't face the hurricane-like headwinds of deficit, debt, and demographics that developed markets, including the U.S., do." Since the market's low, the MSCI Emerging Markets index has shot up 77 percent—20 full percentage points better than the S&P 500. Not that no one has noticed: Emerging-market stock funds have consistently taken in multiples of their U.S. counterparts for five years. And while the U.S. and Europe have swooned in the past month, the emerging markets have fallen 15 percent, a resilient showing for a category that has historically been incapable of handling contagion. West thinks that investors in emerging markets amid this global risk realignment will be disproportionately rewarded over the coming decade.

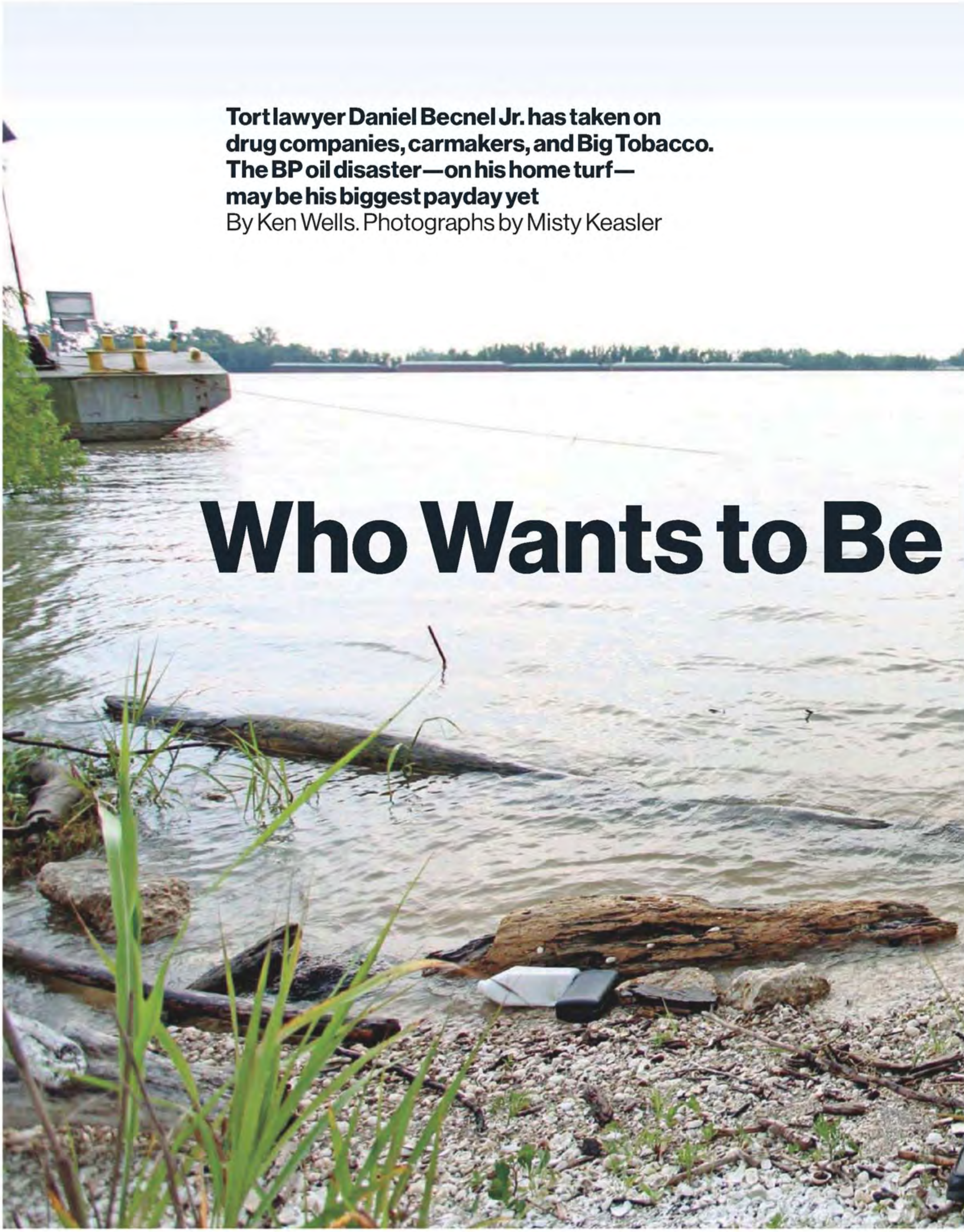
If you don't have the stomach for increasing volatility, you might just take the old advice to sell in May and go away. Or you might park your dollars in gold, which is trading at an all-time high and is certain to go higher, unless it doesn't. Or you might go to cash, which the Federal Reserve is deliberately pegging at all-time low yields, guaranteeing that inflation eats away at what you have.

The sun will rise again, but in the meantime, no one is saying anything about sleeping well tonight. B

Tort lawyer Daniel Becnel Jr. has taken on drug companies, carmakers, and Big Tobacco. The BP oil disaster—on his home turf—may be his biggest payday yet

By Ken Wells. Photographs by Misty Keasler

Who Wants to Be





Becnel on the banks of the Mississippi River near his hometown of Garyville, La.

Daniel Becnel Jr., speed dialing over a speaker phone, places a call to a lawyer for a defendant in the British Petroleum-Deepwater Horizon rig explosion and oil spill.

"This is the king of torts calling," he says when he reaches the attorney's executive assistant.

"Oh," she says. "Then it must be Danny Becnel."

Becnel, adjusting his gold-rimmed glasses, nods appreciatively from his mahogany desk strewn with an impressive pile of legal papers. It's from here, in a French colonial-style office in Reserve, La., population 10,000, that he orchestrated the filing of the first federal lawsuit eight days after the Apr. 20 blowout, and where he tracks the legal squadrons gathering to sue BP and its contractors for claims that experts say could add up to a half-a-trillion dollars or more. About 110 suits have been filed so far, according to Becnel, and dozens more appear to be on the way.

"So where the hell is Jimmy?" Becnel says to the assistant on the phone.

The sought-after party is in a meeting, but the assistant promises a quick return call. Before hanging up, she says: "Danny, would you give me some inside scoop, because I really enjoy hearing things before they get to the lawyers here."

"Now, why do you think I know stuff?" he asks.

She laughs: "Because you're the one who has the direct-dial phone to the White House."

As the spill spreads, waves of lawyers have followed. Becnel, as is his custom, is surfing out front. So far, he and partnering law firms have filed nine federal suits–representing Louisiana commercial fishermen, a New Orleans area oyster restaurant, and Key West charter boat operators, among others–and they're preparing to file three or four more.

Becnel, 65, is soft-spoken. In his khakis, open-collar shirt, and fondness for breaking out dog-eared volumes on industrial safety, he might be mistaken for an engineering professor. In fact, he has represented plaintiffs in some of the highest-profile class actions in American history, from fen-phen diet pills and Big Tobacco to Dow Corning breast implants and the recent Toyota sudden-acceleration cases. He demurs as to whether he actually has a direct line to the White House, though he openly admires the President, and Bradley Becnel, one of his four children, is an advance man for the Obama Administration, helping set up Presidential visits all over the world.

Addressing reports circulating on a spill litigation website that U.S. Navy submarines are tracking the oil spill, Becnel says it was his attorney brother, Robert Becnel, who contacted his "close personal friend" U.S. Navy Secretary Ray Mabus about the need for the government to monitor where the oil is going. (A Defense Dept. spokesman says the Navy has provided skimmer boats and other equipment to the spill-containment effort but knows of no submarine involvement.)



Some 300 tort lawyers gathered in a New Orleans Sheraton for a symposium on the spill. Below, an oil-soaked pelican

Becnel has plenty of competition in the BP litigation stakes. The spill, says Jerrold Parker, a Bonita Springs (Fla.) lawyer, may turn into "the largest disaster in American history" and is already a mass tort bonanza. A recent seminar sponsored by the Louisiana State Bar Assn. at New Orleans' downtown Sheraton Hotel, at which Becnel was one of the speakers, attracted about 300 tort attorneys from around the country. "Ultimately, you're talking about thousands of lawyers being involved," says Richard J. Arsenault, a dean of the Louisiana tort bar who is working several cases with Becnel.

People who know him aren't surprised to find Becnel in the center of the litigation. "[Becnel is] like a firehouse dog," says James Roussel, a longtime acquaintance and sometimes legal adversary of Becnel's who is a defense lawyer with the New Orleans arm of Baker Donelson Bearman Caldwell & Berkowitz. "When the bell rings, he's out the door."

What makes the BP case so extraordinary is the potential for the spill to damage the economies of the five Gulf states–Alabama, Florida, Louisiana, Mississippi, and Texas–and the livelihoods of tens of thousands of citizens who live there. Should the oil start moving up the East Coast, damage claims will spread with it. According to the latest National Oceanic & Atmospheric Administration estimates, the spill forms a surface slick at least 130 miles long and 70 miles wide that stretches from about 30 miles west of the Mississippi River to the offshore waters of western Florida. Roughly 45 miles of Louisiana's coastline of marshy bays and sandy barrier islands have already been coated with oil, a state of Louisiana website reported on May 26. Oil-sickened pelicans are being pulled out of the water around Grand Isle, the state's one sandy beach resort about 60 miles below New



PELICAN: JOHN MOORE/GETTY IMAGES



Orleans. Oil from the blown-out rig, which independent scientists have told Congress could be gushing at ten times the BP estimate of 5,000 barrels a day, has entered the Gulf Stream and could be headed toward the tip of Florida, the coast of Cuba, and beyond, according to the European Space Agency, which has been monitoring the spill by satellite.

Becnel estimates that the actual damages, as opposed to total claims, will run $20 billion to $50 billion. That would dwarf the $5 billion judgment that was rendered in the 1989 Exxon Valdez Alaska spill, which involved more than 32,000 plaintiffs, before it was reduced to about $500 million by a 2008 Supreme Court decision. BP recently waived a $75 million limit on environmental damages relating to the spill and has pledged to cover costs, whatever they are. The numbers and class of people who have claims are going to be "extraordinary," says Camilo K. Salas III, a New Orleans lawyer who is working with Becnel on some of the litigation.

Already, charter boat captains and resort operators from as far away as Texas and Florida have sued as clients scared off by the spill canceled trips. Many of Louisiana's 15,000 commercial fishermen are filing claims as the spill shuts down and pollutes shrimping and oyster grounds in an industry valued at about $2.5 billion a year. The spill couldn't have come at a worse time for shrimpers, who were entering the peak spring season when the leak began.

The district attorney of Terrebonne Parish, La.—where long tongues of oil were just discovered drifting into Lake Barre, a popular sports fishing and shrimp-trawling area—has filed suit to recover damages on behalf of the parish's wildlife. Two environmental groups, the Gulf Restoration Network and the Sierra Club, have sued the U.S. Minerals Management Service for its alleged failure to require companies drilling in the Gulf to have adequate worst-case scenario plans for dealing with spills. Meanwhile, the Louisiana Municipal Police Employees' Retirement System has sued BP, accusing the company of damaging shareholders by opting to maximize output at its rigs such as the Deepwater Horizon instead of complying with safety regulations.

Long established lawyers like Becnel lure clients through word-of-mouth or through a network of attorneys who work the nationwide mass-tort circuit. Other lawyers have to hustle. In Chauvin, La., a fishing community south of Houma where BP is staging some of its spill-containment operations, lawyers have been swarming community meetings and docks trying to sign up hundreds of commercial fishermen for their lawsuits, says Kimberly Chauvin, co-owner of Mariah Jade Shrimp Co. "It's like sharks feeding on guppies down here. The lawyers are the only ones who ever come out winners in situations like this."

One of Becnel's cases involves a Mandeville (La.) sports fisherman named Tom Garner, who has filed a class action in New Orleans federal district court on behalf of Louisiana's millions of outdoor enthusiasts who use the wetlands in this fishing- and hunting-mad state for recreation (Louisiana's license plates bear the slogan "Sportsman's Paradise"). In his suit Garner says "the ever-growing oil spill has already caused serious and permanent environmental damage to the Louisiana coast," depriving both recreational and commercial users access to an ecosystem that is also "the first line of defense from storms and hurricanes."

The suit further alleges that the explosion, sinking of the rig, and oil spill were a direct result of BP's negligence in "providing blowout preventers that did not work properly and were not calibrated" and by "conducting well and well cap cementing operations improperly by removing mud from the well before cementing the well, a procedure which is never done."

Becnel thinks the company's legal woes will worsen if further evidence shows it operated in a culture that put profit before safety; he cites congressional testimony earlier this month suggesting BP ignored signs that a cement job meant to maintain well pressure was faulty and that the blowout preventer may have been previously damaged."They were in a hurry to finish this job, because it was so expensive," says Becnel. "In the rush, they made a chain of bad decisions." BP declined to comment.

Becnel takes pride in having refused to move his law operations 35 miles downriver to New Orleans, where most of the local tort lawyers have splashy offices. He often describes himself as a "country lawyer," although he hasn't fooled anyone

"It's like sharks feeding on guppies down here. The lawyers are the only ones who ever come out winners in situations like this."
Kimberly Chauvin, co-owner of Mariah Jade Shrimp Co.

with that bit of mythology in quite a while. "Danny's a wheeler-dealer," says Roussel of Baker Donelson. "He's a good guy, but the country lawyer thing is kind of a shtick. Some people don't like him. They don't think he's very effective. They are somewhat jealous of him." Roussel says Becnel's sense of self-worth can be grating. "One thing about Danny–nobody has a higher impression of him than he does of himself."

Becnel says that he simply works harder than most of his colleagues. "Most tort lawyers are lazy," he says. "I'm always working. You know how many hours a night I sleep? Four."

He turns to his colleague, Salas, who is in his office: "What time do you start getting calls from me some mornings?"

"Four a.m.," says Salas.

Whatever other lawyers say about him, Becnel has a pile of victories that speak volumes. He won a million-dollar judgment in a 1972 car accident case when he was three years out of Loyola University law school, and since then, Becnel has been involved in six billion-dollar-plus settlements. Those include the national tobacco litigation, in which he was part of a large team of lawyers sharing a $1.65 billion fee in California alone, and the Dow-Corning breast-implant defect cases, in which his firm was among several that won a global $7.2 billion 2001 settlement that was later reduced when Dow-Corning took the case to bankruptcy court. He was also a lead lawyer in the post-Katrina, $330 million settlement against Murphy Oil over a tank spill during the storm that unleashed more than 1 million gallons of oil in several neighborhoods in St. Bernard Parish below New Orleans.

Becnel says he first heard about the Deepwater Horizon blowout from a personal-injury attorney friend who tracked him down by phone at the Wynn Las Vegas hotel where he was attending a two-day, $1,395 seminar called "Mass Torts Made Perfect." "I said to my friend, 'You take the personal injury cases, and we'll handle the environmental litigation,'" says Becnel. Since then, Becnel has asked a federal judicial panel to consolidate the lawsuits into a class action to avoid what he calls "judicial chaos." He also filed motions in New Orleans federal district court for an expedited hearing on the matter of where the suits will be heard. (So far they have been denied.) BP and its contractors are trying to get the cases transferred to Houston; The Louisiana bar and a huge chorus of local residents argue the suits ought to stay put.

Resume Daniel Becnel Jr

Born — June 14, 1944

Education — Bachelor of science from Louisiana State University; law degree from Loyola University New Orleans

Milestones — First $1 million verdict came in a 1972 car accident suit; his biggest class action so far was the $22 billion global settlement in the Wyeth fen-phen diet pill case

Cars — 17 Mercedes-Benz diesels

Leisure Activities — Riding his 12 tractors, gardening, and trawling for shrimp in the Louisiana bayous

"If it goes to Houston, there will be a huge uproar down here," says Roussel, who declined to handicap the decision either way. If an expedited hearing isn't granted, the issue will be heard July 29 in federal court in Boise, Idaho.

While Becnel says he takes all of his cases personally, this one has particular resonance. Born in New Orleans, he grew up in a middle-class family in Garyville, La., near Reserve. His father, D. Elmore Becnel, was a military prosecutor after World War II who settled back in Louisiana as small-town lawyer. His mother was a nurse. Back then, Reserve was a rustic hamlet of a few hundred people with a gravel road paralleling the towering levees of the Mississippi River. The town sat amid thousands of acres of sugar cane fields and woodlands interspersed with the aging plantations of sugar barons who had built them in the previous century.

Like most men and a lot of women in South Louisiana, Becnel spent his youth hunting and fishing the wild lands around him and often ventured down into the saltwater estuary, the system most under siege by the oil spill, to spend a day trawling for shrimp. He echoes a refrain heard over and over–that it's not just an ecosystem under assault but a way of life. "This is making people physically sick," he says.

A short drive from his office is a 15-acre gated compound that holds his house, a guest house, pool, horse paddock, barns, vegetable gardens, and a hurricane bunker. At a table in the guest house, over a lunch of chicken-and-andouille gumbo prepared by his cook, Becnel talks about his attachment to his hometown and the influences that prompted him to become a tort lawyer. His ancestors were part of a wave of German migration to Louisiana's Mississippi coast starting in the 1720s. His father died in 1965 at the age of 57 from lung cancer after an adult lifetime as a smoker. His estate was a house valued at $14,000 with a $7,000 mortgage remaining on it. Becnel worked his way through Louisiana State University, earning a bachelor of science degree in 1966. During law school at Loyola, he took a job as a night dispatcher for the local sheriff's office. "That's where I learned not to sleep," he says.

When Becnel graduated from Loyola in 1969, he had few resources. He rented one quarter of a tiny cinder-block building from the local gas company within walking distance of the office he now owns and occupies. The space, he recalls, was so small that he had to crawl over the top of his desk to get in and out.

Becnel envisioned himself as a small-town lawyer handling wills and property transactions. One of his first clients was a young woman, on the cusp of her honeymoon, who wanted to get her car transferred to her soon-to-be husband's name. "It was a $3 fee, and at that point I was dying for that $3," he says. "I said, 'no charge.' But I told her: 'Look, one day you might have a good case, don't forget me.'"

She didn't. The woman, Paulette Trosclair, sought out Becnel when she was later injured in a horrific car accident. Her case went to trial in Jefferson Parish and netted Becnel his first million-dollar verdict. His career as a tort lawyer was born.

Becnel doesn't mind talking about how well he's done, how good he is at what he does, and whom he knows. He also likes to drop names. His office and home are decorated with photos of Becnel and Jimmy Carter, Becnel and Ronald Reagan, Becnel and Hillary Clinton, Becnel and John Kerry, among others.

He shows off several of the 17 Mercedes-Benzes that he owns, some of which he assigns to his staff to drive. "I have 12 trac-



Becnel, in his Reserve (La.) office, likes to describe himself as a "country lawyer"

tors," he says, each one hooked to a separate implement that he uses to do yard work. The explanation is that he can't change implements because he donated a kidney several years ago to his brother, and rib-cage weakness prevents him from heavy lifting. It doesn't, however, prevent him from mowing his own grass from on top of a tractor or from working in his multi-acre vegetable garden, which he has rigged with night lights so that he can garden through bouts of insomnia. "Ten p.m. or 3 a.m., it doesn't matter. I could be out there," he says.

An inveterate tinkerer, Becnel completed a 3,000 square-foot hurricane bunker–made from structural steel and rod-trussed, concrete-filled cinderblocks–earlier this year, which he says will withstand 250 mile-per-hour winds and can hold several families. He has hooked it all up to a generator that he says "could run two city blocks," and he has 20,000 gallons of diesel in underground tanks to power it.

He has a 40,000-acre ranch near Aspen, Colo.–a fact he mentions more than once–and takes a visitor on a tour of his main house, where he shows off a bathroom and curved walk-through closet used by his wife, Mary Hotard Becnel, a local judge. The addition was completed several years ago and was designed by Bill Gates' architect, whom he knows from Aspen. Becnel says his other holdings include about 4,000 acres of land in and around Reserve where he keeps 500 chickens to supply fresh eggs for his compound and for friends.

Ironically, Marathon Oil has a large refining operation in nearby Garyville that partly occupies property that Becnel says he sold the company. Earlier this month, an explosion ripped through a boiler there, causing injuries. So far around 200 plaintiffs have poured into Becnel's law office to sue.

"I'm probably one of the few people in the country who doesn't accept his Social Security," Becnel says. "I could retire, but I don't because I just love the work."

Becnel and the other spill lawyers may have a big job ahead of them if the Exxon Valdez litigation is a foreshadowing of the BP cases. Exxon fought the $5 billion Alaska state court damage verdict for 19 years, all the way to the U.S. Supreme Court. Although the oil giant spent $3.4 billion to clean up 1,200 miles of Alaskan shoreline, and tens of millions more on legal fees, it eventually won a $4.5 billion reduction from the Supreme Court on the punitive damages. On the other hand, "this is a radically different fact pattern than Exxon Valdez," says Arsenault. While the Exxon Valdez disaster was blamed on a drunken ship captain, "the BP spill follows a very troubling pattern of systemic failures." Arsenault also doubts that our "judicial, legislative, and executive branches will allow a repeat" of the drawn-out Exxon Valdez case. So far, at least, BP is playing contrite corporate citizen, offering to help commercial fishermen with their bills and providing no hints about its legal defense strategies.

Becnel thinks that no matter how large the judgments finally are, BP will be able to shoulder the costs of a massive clean-up and the damage claims simply based on the value of its oil reserves. A parallel can be found in the case of U.S. tobacco companies, which continue to pay claims, estimated at more than $270 billion, out of future income. Salas, Becnel's partner in the litigation, says that he has another theory of how BP will finance the damages: "The American people will ultimately pay for it at the gas pump." B



Abu Dhabi's Man in New York

Or is it the other way around? John Sexton, the president of New York University, is set to open a new campus in Abu Dhabi, expand aggressively at home, and turn his school into a global franchise.
By John Hechinger. Photographs by Michael Edwards

John Sexton, the president of New York University, typically greets students, faculty, and even strangers with a bear hug, and word has spread. When he taught a class in Abu Dhabi, where NYU is about to open a campus, three male students from the United Arab Emirates opened their arms to him. Knowing that Middle East convention barred him from touching female students, Sexton decided he needed a technique to cover both genders. So the 67-year-old, white-bearded president gave each student a fist bump.

"I told them I will not give them a hug until they have an NYU degree," Sexton says. "I just didn't want to be too violative of social norms."

Sexton is part scholar, part showman, and his plans for NYU are as audacious as his personality. While Harvard University shelves construction projects because of endowment losses, Sexton is barreling ahead with a massive expansion, both at home and abroad. The NYU branch in Abu Dhabi, set to open in September, is bankrolled entirely by the oil-rich emirate, and in the midst of a weak economy, Sexton plans to raise more than $3 billion to beef up the university's New York campus. His goal: to transform NYU, already the largest nonprofit university in the U.S., with 43,000 students, into one of the world's best.

"The time is right," Sexton says in his office in Greenwich Village. "New York is the anchor, thus the expansion. We're building Abu Dhabi as part of a circulatory system on six continents. You choose a continent for your next semester as easily as you choose a course. If you're an Indian economist who has an aging mother in Bombay, we can have you in Abu Dhabi where you can go home for a weekend."

Sexton's use of foreign money to raise NYU's academic sights may become a model for other ambitious leaders, says Terry W. Hartle, senior vice-president of the Washington-based American Council on Education, which represents 1,600 college presidents. "If he succeeds, John Sexton will have transformed not only NYU but American higher education," Hartle says. The pitfalls are everywhere. While Sexton has charmed donors and Middle East royalty, his diplomatic skills are being tested at home. Financial aid students complain about stingy scholarships, Greenwich Village neighbors protest that NYU is ruining their quirky community, and critics on his own faculty worry he is risking NYU's reputation for the sake of petrodollars.

Sexton's goals would have been unimaginable in the 1970s, when NYU, then a commuter college, sold its Bronx campus to survive. Under Sexton's predecessors, including former Indiana Representative John Brademas, NYU transformed itself from a school with largely open admissions to one that rejects two out of three applicants.

Still, even now, finances challenge Sexton's ambitions. The university has a $2.2 billion endowment. Though its stash dropped almost a third in the financial crisis, Harvard University still has $26 billion, the richest in the world. Its investment pool amounts to $1.3 million per student, Yale University has $1.4 million, and Princeton University, $1.7 million. NYU: about $50,000.



Abu Dhabi's Crown Prince Al Nahyan wanted a "full-out university," not executive education programs

Sexton shares NYU's modest roots and high aspirations. He grew up in an Irish-Catholic family in Queens' Rockaway Beach, worshipping the underdog Brooklyn Dodgers. Sexton had second baseman Jackie Robinson's number sewn onto the sleeve of his academic gown and still makes a spitting sound at the mention of the team's late owner, Walter O'Malley, who moved the Dodgers to Los Angeles after the 1957 season. As a major influence on his life, Sexton cites his English teacher, Charlie Winans, who taught him to stretch intellectually. "Think strange," Winans would tell his students at Jesuit Brooklyn Prep.

That didn't make young Sexton a model student. He graduated from Fordham College in the Bronx with a 2.1 grade point average, focusing more on a volunteer job he held for 15 years: coaching a Catholic girls' high school debate team that won five national championships. He became a better student and went on to earn his PhD from Fordham University in the history of American religion, and to teach religion at St. Francis College in Brooklyn.

When Sexton was 30, a group of high-powered friends from debating circles, including Laurence H. Tribe, the Harvard Law School professor, pushed him to apply to law school. Five universities, including NYU, rejected him. Tribe helped persuade Harvard to change its mind.

As a first-year law student, Sexton had a famous confrontation with Arthur R. Miller, the civil-procedure professor whose tough questioning inspired fear in the best-prepared students. The first time Miller called on Sexton, the professor asked him about a case Sexton knew well from his debating years.

Sexton ended up sparring with Miller for most of the 50-minute class, making up mind-bending legal hypotheticals, contradicting Miller's assumptions, and even trading scholarly insults in an academic version of a Brooklyn street fight.

"It was a performance," Miller remembers. "Let's see if I can kill the king and establish my reputation." Miller was impressed, offering that day to write Sexton a recommendation. The next year, he asked Sexton to teach his class while Miller was traveling.

Sexton was also trying to win over a woman in Miller's class, Lisa E. Goldberg, whom he would soon marry. The couple raised two children, Jed, an actor and SAT tutor, and Katie, who just graduated from Yale. Lisa, who was president of the Charles H. Revson Foundation, died in 2007 of a brain aneurysm at age 54.

After law school, Sexton clerked for U.S. Supreme Court Chief Justice Warren E. Burger, joined NYU as a law professor, and became its dean in 1988. In 2001, trustees named Sexton to the president's post, which now pays about $1.3 million annually. The board hoped he could raise the profile of NYU in much the same way as he had the law school. Sexton focused on wooing academic talent, as well as donors who were skeptical of his vision. On a brilliant spring day several years ago, Sexton invited philanthropist Catherine B. Reynolds to the president's official residence, with terraces overlooking Washington Square Park. Reynolds' foundation had recently made a $10 million gift to Harvard. Sexton had invited her to sit on NYU's board.

"This is NYU," Reynolds recalls Sexton saying, with a sweep of his arm. "Don't you love it?"

"Where is it?" Reynolds replied. Sexton looked deflated, she says. She also declined to join the board.

Every few months, Sexton had lunch with

Reynolds, sharing his vision for NYU. A year later she joined its board, and her foundation gave the university $10 million.

Such perseverance has made Sexton a master fundraiser. NYU ranked No. 11 in donations to U.S. colleges last year, compared with No. 27 the year Sexton was named president, according to the Council for Aid to Education. In 2008, Sexton completed a $3.08 billion campaign. In recent years, NYU climbed to 52 from 79 in the London-based *Times Higher Education* world university rankings.

NYU ranks more poorly by some other measures. Half its faculty is part-time, compared with about 20 percent at Columbia and Harvard. The average NYU undergraduate leaves with about $35,000 in debt because NYU offers few scholarship grants, according to the nonprofit Institute for College Access & Success in Oakland, Calif. NYU's average undergraduate debt level is almost twice Columbia's and three times Harvard's, the institute says. NYU's tuition, room, and board fees are $53,600.

Maria Louis, 21, who is from San Francisco, says she left NYU in 2009 after two years because of the cost and scant contact with full professors. "NYU is not affordable in any capacity," she says. "I don't want to have to spend the rest of my life in debt."

The university is working to improve aid, even with its small endowment, Sexton says. Tenured professors make it a priority to teach undergraduates, and many adjuncts are often accomplished professionals, he says.

Sexton in March unveiled a plan to expand NYU's New York City campus by 40 percent, or 6 million square feet. The proposal may cost between $3 billion and $4 billion, according to Martin Lipton, a lawyer and chairman of the board of trustees.

Last month, Sexton invited community activists to an NYU-owned mansion on Fifth Avenue and spoke to them of the college's role in cementing NYU's position as a world capital of ideas. Neighbors say he was purposely minimizing their concerns, using rhetorical flourishes to avoid discussing nuts-and-bolts complaints about the expansion's impact on the neighborhood. "NYU is part of a great goal of keeping New York City the world's capital," says Martin Tessler, a former urban planner who represents Greenwich Village Block Associations. "How do you argue with that without appearing parochial and provincial?"

Sexton considers cosmopolitan New York as the heart of NYU's transformation into a global university. Among 16 study-abroad sites, NYU will include at least two full-fledged campuses with degree-granting power—in Abu Dhabi and, most likely, China, where Sexton has his sights set on the Pudong district of Shanghai and expects a deal to be struck within the next few months. All this requires a grueling travel regimen. Sexton takes a 14-hour flight almost every third weekend to Abu Dhabi, leaving at 9 p.m. Friday and making it back to his desk in Manhattan by 10 a.m. on Monday. In Abu Dhabi, he has cultivated a friendship with Crown Prince Mohammed bin Zayed Al Nahyan, whom he first met four years ago when the two men shared a meal of dates and coffee in the royal court. Sexton had been warned by advisers not to violate protocol by hugging royalty.

"At what level of ambition can we do this?" Sexton recalled the prince asking.

"The only reason to do it is if we could create one of the five or ten best universities in the world," Sexton replied.

As he left the meeting, Sexton felt confident he had made a connection, he says. On one matter the prince, in his traditional flowing white robes, was disappointed. He had heard about Sexton's outgoing reputation.

"What, no hug?" the prince asked, before the two embraced.

The crown prince met with many other university presidents, though their vision was narrower, says Yousef Al Otaiba, ambassador of the United Arab Emirates to the U.S. Other college chiefs suggested executive education programs, not degree-granting research institutions. "We wanted a full-out university," he says.

Along with paying all costs associated with the university, Abu Dhabi, part of the United Arab Emirates, will reimburse NYU for the cost of replacing NYU faculty who relocate to the Middle East. Abu Dhabi has also made a $50 million unrestricted gift to NYU. Sexton describes it as a "gesture" rather than part of the agreement.

Some faculty are concerned that the school's growing dependence on oil money will affect academic freedom, says Andrew Ross, an NYU professor of social and cultural anal-

Exporting Education U.S. Schools with Campuses in the Middle East



Bahrain	*Adliya*	New York Institute of Technology
Israel	*Ramat Gan*	Clark University
Jordan	*Amman*	DePaul University
Qatar	*Doha*	Carnegie Mellon University
		Cornell University
		Georgetown University
		Northwestern University
		Texas A&M University
		Virginia Commonwealth University
UAE	*Abu Dhabi*	New York Film Academy
		New York Institute of Technology
		New York University *(pictured above)*
	Dubai	American Intercontinental University
		Boston University School of Dental Medicine
		Harvard Medical International
		Hult International Business School
		Michigan State University
		Rochester Institute of Technology

DATA: THE OBSERVATORY ON BORDERLESS HIGHER EDUCATION

PREVIOUS PAGE: WAM/AP PHOTO; THIS PAGE: RICH-JOSEPH FACUN/THE NATIONAL



Sexton in Washington Square: NYU's expansion plans have riled its Greenwich Village neighbors

ysis. The flashpoints are Abu Dhabi's lack of diplomatic relations with Israel, its intolerance of homosexuality, and its treatment of migrant labor, says Ross, president of NYU's chapter of the American Association of University Professors. Sexton says Israeli professors will be able to travel to the campus, as well as gay students and teachers, and NYU is monitoring labor practices.

Ronald W. Zweig, an NYU Israel studies professor and an Israeli citizen who traveled to Abu Dhabi, says officials there assured him he'd be able to come and go as he pleased and teach whatever he liked. "It's certainly a potentially risky venture, given that NYU's prestige is on the line," Zweig says. "It's very brave that John Sexton is moving forward with it."

In its temporary home, NYU Abu Dhabi is currently a pair of unassuming glass-and-metal three-story buildings, connected by a footbridge. Students will live in a 45-story glass skyscraper nearby. Sexton will open Abu Dhabi's permanent campus in 2014 on an island featuring a golf course and prime beachfront land. Its neighbors will include branches of the Guggenheim and the Louvre museums.

Sexton's desert adventure is part of a push by U.S. universities to create international franchises. Carnegie Mellon, Georgetown, Texas A&M, and Michigan State universities have opened Middle East branch campuses. Cornell University has a medical school in Qatar. Sexton says NYU is planning what it says are broader offerings than any of its peers: a full-scale research university in Abu Dhabi, with a liberal arts college and graduate and professional schools that award the same degrees as at the Manhattan campus.

Columbia University, NYU's New York rival, turned down an offer to open a law school in Qatar, President Lee C. Bollinger says. A degree-granting campus abroad may generate excitement initially but over time may struggle to attract the same quality of students and faculty, he says: "The biggest concern is you dilute your reputation. You lower the quality of what your institution is offering."

NYU will raise its standards in Abu Dhabi, not diminish them, Sexton says. NYU Abu Dhabi will be so choosy that students accepted there will be "clearly admissible to any college or university in the world," and its faculty will include Nobel and Pulitzer prize winners, he says. "We are very confident we can sustain the quality, not just for this year or the next five years but literally for the generations," Sexton says.

Sexton took a leading role in steering 275 of this year's strongest applicants to NYU Abu Dhabi. With money from the emirate, he hosted them on all-expense-paid trips to Abu Dhabi, featuring a five-star beachfront hotel, a desert picnic, and dancers with swords.

In November, NYU flew in Adam Pivirotto, a senior from Norfolk, Va. In one gathering of prospective students, Sexton used a metaphor from Taoism to describe the Abu Dhabi campus. He spoke of the limitless potential of the unformed block of wood, contrasting it with a polished antique table. Pivirotto, with a 4.6-point grade point average, saw Sexton's comments as a pitch for NYU Abu Dhabi over Princeton, his grandfather's alma mater.

"He was so passionate about the future of the school," says Pivirotto, who is considering majoring in international relations. "He was really selling it to us."

NYU admitted 188 students out of 9,048 applicants for the first class, from more than 35 countries. The university says it does not yet have median SAT scores calculated. By 2020, enrollment is projected to grow to 2,000. Pivirotto will attend on a full scholarship, courtesy of Abu Dhabi. "We're hoping to be the magnet for the flow of ideas and talent that we envision as characteristic of the 21st century," Sexton says. "There will be a flow of creativity among idea capitals in what will be a kind of 21st century version of the Renaissance."

Back at NYU, Sexton incorporates some of these expansive ideas into the classroom. His most recent course, "Baseball as a Road to God," mixed his love of high and low culture, theology and baseball, the down-to-earth and what he calls the "ineffable." He is a lively teacher. In one of the class's final meetings he threw a mock tantrum at the sight of a student's Red Sox cap, ripping it off his head, throwing it to the ground, and stomping on it. Then he expounded on writers Ernest Hemingway, John Updike, and Robert Caro, musician Louis Armstrong, philosopher Paul Tillich, and the Yankees' Alex Rodriguez and Derek Jeter. "This course is predicated on the fact that we are going to ask this oxymoronic question–is baseball a road to God?–and see if anything comes out of it," he told the students. "It's what we said the first day. It's all about thinking strange." B

—With reporting from Vivian Salama in Abu Dhabi and Max Raskin in New York



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Do leave home without this one. Page 80

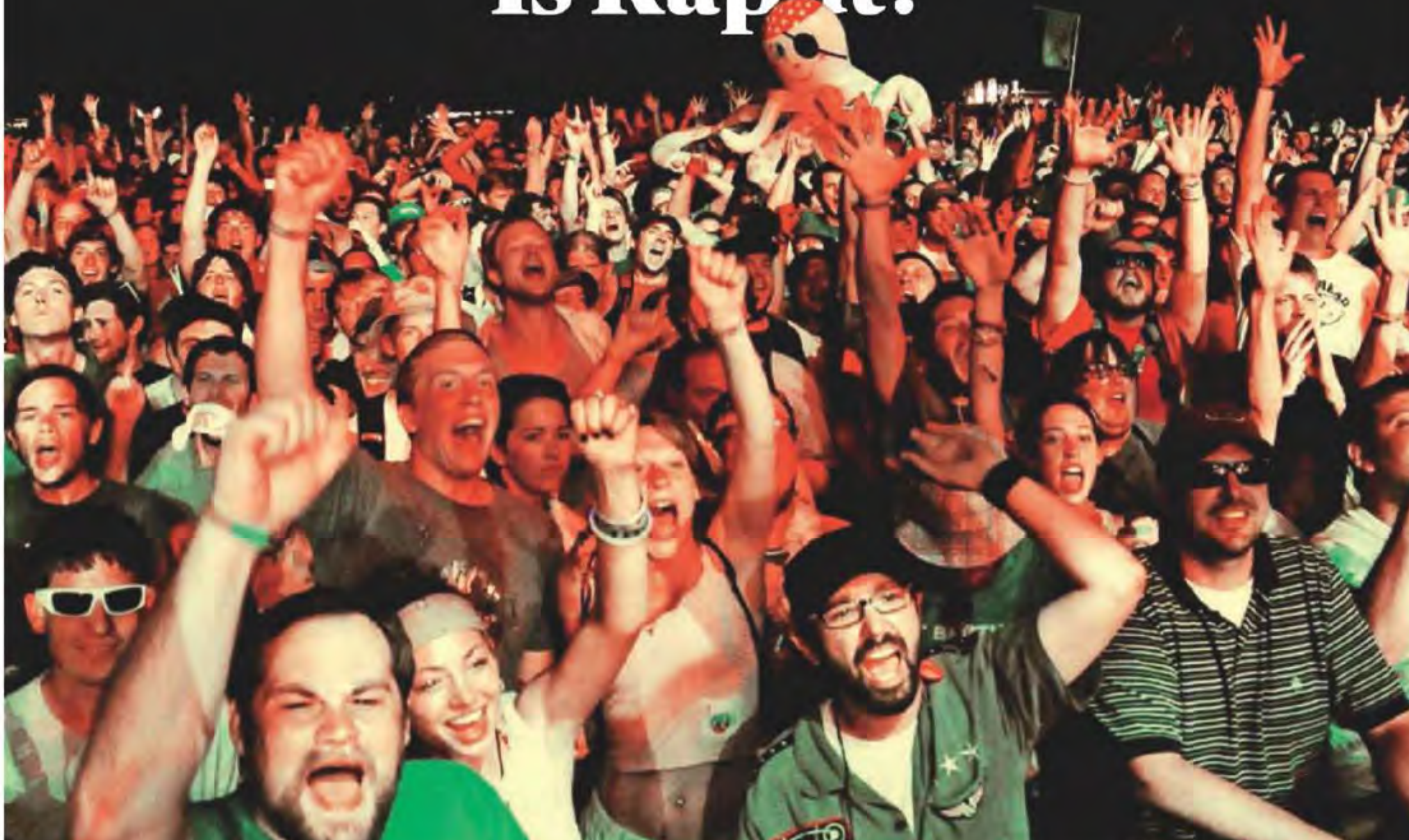
Apps & Sweaters & Art Basel & Hotels & Oil

Etc.

Streamline your gallery-hopping. Page 84



Who Says the Music Industry Is Kaput?



By paying attention to details, Nashville festival Bonnaroo has become a thriving business. *By Josh Eells*

SCULPTURE: COURTESY DO HO SUH AND LEHMANN MAUPIN GALLERY; BONNAROO: JEFF KRAVITZ/FILMMAGIC

Etc. Bonnaroo

It was the fall of 2001, and Jonathan Mayers was stuck. He had built Superfly Presents—the New Orleans-based concert promotion company he ran with three friends—into a local success, staging some 120 shows a year and earning around $1 million. However, Mayers and his partners—Rick Farman, Richard Goodstone, and Kerry Black—were tired of the nightly grind, the razor-thin profit margins, and the battle with industry colossus Clear Channel Communications. They realized there was only so much money to be made staging rock and jazz shows for a few hundred people a night. "We saw there was a ceiling to what we were doing," Mayers says. "We had to take a risk."

That decision led to the founding of the Bonnaroo Music and Arts Festival, a 100-band jamboree that has been the top-grossing music festival in North America for eight years running. This year, from June 10-13, 75,000 fans will make the pilgrimage to a 700-acre farm an hour southeast of Nashville for what observers ranging from *Rolling Stone* to the concert chronicler Pollstar have called the best music festival in the country.

As live concerts have supplanted album sales as the music industry's chief moneymaker, Bonnaroo (which means "good times" in Creole) has flourished. Ticket prices range from $250 for a general-admission pass to $18,500 for a luxury package that includes an air-conditioned bus, on-stage VIP viewing platforms, and a chauffeured golf cart to shuttle between the two. Meanwhile, the promoters have 16 other profit centers on-site, including concessions, merchandise and, yes, paid showers. Last year the festival grossed around $30 million, approximately $18 million of which came from ticket sales. And since, according to Goodstone, Bonnaroo "funds itself on ticket sales," the other $12 million was profit.

"It's really as modern a music formula as you could have right now," says Ray Waddell, the longtime touring guru for industry publication *Billboard*. "They're focused on the live experience, but they also branch off into these other directions—licensing, media deals, the Web. They've really broadened the revenue stream."

$18,500
The price of a luxury package ticket at Bonnaroo

$18 million
Gross ticket sales of last year's festival

DATA: BILLBOARD BOXSCORE

The first Bonnaroo, held in 2002, featured mostly jam bands and cult acts such as Ben Harper, Jack Johnson, and the Grateful Dead's Phil Lesh. As the festival has grown, it has diversified to encompass an eclectic mix of A-list stars, from Radiohead and Pearl Jam to Metallica and the Beastie Boys. This year's headliners offer something for every demo: Jay-Z and Kings of Leon for the college kids, Stevie Wonder for the boomers, and the Dave Matthews Band for the hacky-sacking base. Bonnaroo also books comedians, including Conan O'Brien this year, and features such amenities as a film tent, gourmet burrito and microbrew stands, and TV banks for watching the NBA finals and, this year, the World Cup.

Daily programming runs from noon until 4 a.m., and an estimated 90 percent of concertgoers stay on-site—either in tents or in one of the fully outfitted RVs provided (for a price) for the camping-averse. "You don't go home at night and turn on CNN or check your e-mail," Farman says. "It's an all-encompassing experience." The goal is to create the kind of communal, anything-goes atmosphere where, say, Bruce Springsteen can play a three-hour headlining set on Saturday night, jam with Phish on Sunday, and in between, stay out until 4 a.m. watching indie-rock band MGMT with his teenage son (all of which happened last year).

"We pay attention to details—that's the business model," Mayers says, sitting on a couch at Superfly's scrappy Manhattan headquarters. The company's aesthetic is college-pad chic: lava lamps, vintage concert posters, jeans, and flip-flops. Scribbled on a dry-erase board is one of their mission statements—"selling authenticity"—while the office Wi-Fi password jokingly recalls rapper Kanye West's diva-like performance at Bonnaroo 2008. (It's "kanyesucks.") The vibe isn't too far removed from Superfly's do-it-yourself early days, when Goodstone once spent a night in jail for posting an illegal concert flier.

Yet the dorm-room atmosphere belies the magnitude of the operation. In addition to Superfly, Bonnaroo is helmed by two other high-powered partners: Ashley Capps, a veteran Knoxville promoter who was instrumental in conceptualizing the festival and securing a site, and Coran Capshaw, a top-shelf talent manager (his clients include Dave Matthews and Tim McGraw) who serves as Bonnaroo's primary financier. Many of the operations team, meanwhile, are veterans of such live-music powerhouses as the Grateful Dead tours and Bill Graham Presents. Together, they plan and manage what, for a weekend, becomes the sixth-largest city in Tennessee.

The casual ethos doesn't mean there isn't a strong commercial instinct. "You've got a captive audience of 80,000 for four days," Waddell says.



GETTY IMAGES (6); AP IMAGES (2); RETNA LTD. (1)

They Work Hard for the Money

Bonnaroo's organizers are tight-lipped when it comes to performance fees, but industry insiders say some paydays reach seven figures. From marquee headliners to afternoon openers, here's what several of this year's acts could make for a day's work.

Starring artists — **Starving artists**



Stevie Wonder
$1,000,000+



Jay-Z
$1,000,000+



Dave Matthews Band
$750,000+



Kings of Leon
$500,000+



The Black Keys
$50,000



Morning Teleportation
$1,000 or less

"That's a hell of a marketing opportunity." Companies like Budweiser, Ford, Canon, and the Cartoon Network shell out top dollar for facetime with Bonnaroo's audience of tastemaking college kids and affluent young professionals. Still, the marketing presence is muted compared with other festivals. There's Bud Light in the VIP tent and Ben & Jerry's new Bonnaroo Buzz flavor in the freezers, but the promoters strive to keep signage to a minimum and have resisted selling naming rights for stages or the festival. "They could do double what they're doing, easy," Waddell says. "But they're real careful about it." It seems to be paying off: In last year's tumbling economy, when high gas prices and tight wallets brought down all other sources of revenue, sponsorships for the festival actually rose.

On the cost side, meanwhile, Bonnaroo is famously thrifty. Organizers keep expenses in-house as much as possible, handling advertising through the newly launched Superfly Marketing Group and ticketing through their own website. As with any festival, the biggest expense is talent: One prominent agent who has booked multiple acts with Bonnaroo over the years estimates that the total cost of this year's bill is around $6 million, with headliners getting $1 million or more each (chart). The economics change, though, the further you go down the bill: Second-tier acts often receive their standard fee or even less, and some lower-rung bands get nothing. They end up playing anyway because of the exposure.

Goodstone recalls that he and his partners would have been thrilled to break even on the first year.



A captive audience of 80,000 for four days is "a hell of a marketing opportunity"

(For a startup music festival, three years of losses is the rule of thumb.) They did better than that: Online word of mouth helped sell out the festival in 18 days, and Bonnaroo has been in the black ever since.

Despite their success, attempts at expansion have so far been ill-fated. A New York installment planned for 2003 was canceled at the last minute because of logistical troubles, while the Superfly-produced Vegoose festival, staged in Las Vegas, held on for three rocky years before folding in 2007. The following year the company launched Outside Lands—a sort of Bonnaroo West, held in San Francisco's Golden Gate Park—which turned a profit the first year but has since followed, as Goodstone says euphemistically, "a more traditional festival model" (i.e., it has lost money).

Lately the partners have been thinking locally. Three years ago they bought the Bonnaroo property and started working on capital improvements like electrical installations and a permanent stage. Capps says they hope to use the site for things like sporting events, as well as other festivals. It's still a risky proposition, though. This year alone, two major festivals—Michigan's Rothbury and New Jersey's All Points West Music Arts Festival—shuttered for lack of funds.

For now, Bonnaroo's best hope for growth is monetizing what Farman calls its "curatorial voice"—expanding the Bonnaroo brand to include everything from television programming and mobile-phone apps to ad space on bonnaroo.com. "We haven't settled on a strategy yet," Farman says. "But we're talking about everything." B

WONDER: FRANK MICELOTTA/GETTY IMAGES; JAY-Z: KEVIN WINTER/GETTY IMAGES; MATTHEWS: JAKUBASZEK/GETTY IMAGES; KINGS OF LEON: KEVIN WINTER/GETTY IMAGES; BLACK KEYS: C. FLANIGAN/FILMMAGIC; MORNING TELEPORTATION: ROBB D. COHEN/RETNA LTD.; WOMAN: JEFF GENTNER/GETTY IMAGES

Etc. Hands On



Remote Control

LogMeIn may be the iPad's first indispensable app

By Rich Jaroslovsky

Don't tell Steve Jobs, but I've been running Adobe Flash on my iPad. Windows 7, too. My Apple heresy comes courtesy of LogMeIn Ignition, an iPad app that allows me to take control of any Internet-connected computer on which I've previously installed a small piece of host software. While LogMeIn's technology has been around for a while, it has taken Apple's new tablet to unlock its potential. Or maybe vice versa: Ignition may be the first indispensable iPad app.

Setup is a snap. Install the $29.99 app from the iTunes App Store, then establish a user name and password. From each computer you want to control, go to the LogMeIn website and download the needed software, a process that takes less than five minutes. The app works with both Windows PCs and Macs.

When you run Ignition on the iPad, you're taken to a list of every machine you've enrolled. (Computers that are online appear in bold, those that are offline are grayed out.) Choose one, and within moments you're looking at the desktop of your computer, right on the iPad. All your open windows, programs, and files are displayed precisely as they would appear if you were sitting at your desk.

At this point, you can accomplish a lot. Using my Windows PC, I updated my bank accounts with Quicken and used the iPad's virtual keyboard to add a few thoughts to a memo I was writing in Microsoft Word. On my iMac, I bought a song from iTunes, added a few entries to my Things to-do list, and browsed Safari to view some sites in all their Flash-enabled glory—something that Apple CEO Jobs won't allow in Safari's iPad/iPhone version.

There are limitations. Your remote computers need to be on and connected to the Internet. Some company networks block the access LogMeIn needs. The app doesn't support sound, and navigation takes some getting used to. If you see an icon on the screen, poke at it, and expect it to respond, it won't; you have to use your finger to maneuver the cursor to the item you want to select.

While the LogMeIn app will also work on an iPhone or iPod touch, the iPad's larger screen is far preferable. You're able to see the entire computer desktop all at once, and you can use the iPad's touch interface to pan around and zoom in if you're finding it hard to line up the cursor with a menu selection—or the X in the corner of a Windows box.

While Ignition isn't cheap in app terms, it is a big step toward making the iPad as important for mobile productivity as it is for consuming media. B

EXECUTIVE APPLICATION

The favorite apps of a few business influentials: By Ira Boudway



Susan Lyne, CEO, Gilt Groupe

Favorite App: Scrabble

"I think I've played every day since the iPad launch"



Mark Cuban, owner, Dallas Mavericks

Favorite App: FilesAnywhere

"Lets me have access to all my documents from my phones"



Steve Stoute, CEO, Translation

Favorite App: RedLaser

"It gives me detailed info on any product that has a bar code"



Dan Hesse, CEO, Sprint

Favorite App: Google Goggles

"Snap an image [with a camera] and receive useful search results"



Shepard Smith, Anchor, Fox News

Favorite App: Texts From Last Night

"Whether or not people actually sent those texts, I get a laugh"

LYNE: STEPHEN LOVEKIN/GETTY IMAGES; CUBAN: GREG NELSON/SPORTS ILLUSTRATED/GETTY IMAGES; STOUTE: RICK DIAMOND/GETTY IMAGES; HESSE: GEORGE NAPOLITANO/GETTY IMAGES; SMITH: PAUL MORIGI/WIREIMAGE; ILLUSTRATION BY ELLIOT THOBURN



Global Green Business Summit

June 8, 2010, Tuesday

Shanghai World Financial Center

The world continues to move toward a low-carbon economy, but without a "global deal" to define the rules of the road. The Great Energy Race is on, and different regions, nations and localities are deploying a wide variety of strategies to accelerate the transition and encourage sustainable behaviour. As a result, business leaders must navigate a global patchwork of standards, mandates and regulatory schemes. For the most nimble companies, this is the time to devise new strategies for an emerging era of uncertainty and opportunity. Those that seize the moment will prosper; those that wait for a detailed rule book risk being left behind.

At our second annual **Global Green Business Summit**, Bloomberg Businessweek and the China Enterprise Confederation will shine a spotlight on the smartest strategies from the most innovative global players. We will also identify new products, services, and processes designed to safeguard the well-being of future generations without sacrificing corporate profit.

Bringing together thought leaders, senior governmental policy-makers and top business executives from a range of sectors, this international summit will examine the key sustainability challenges and opportunities of the next five to ten years. The race is on—and the Global Green Business Summit offers a crucially important map to what lies ahead.

Conference Co-Chairmen:
Norman Pearlstine, Chief Content Officer, Bloomberg L.P. & Chairman, Bloomberg Businessweek
Wang Zhongyu, President, China Enterprise Confederation

Why attend?
- Hear how global brands are implementing profitable green solutions to the challenges of climate change
- Come to grips with the strategic implications of a de-carbonized global economy
- Network at a senior level with other green business visionaries
- Understand the implications of new and upcoming policy and regulations
- Discover how you can maximize both financial return and social good
- Exchange ideas, hear about new initiatives, and brainstorm solutions

Speakers under Invitation :
- Xie Zhenhua, Vice Chairman, National Development and Reform Commission (NDRC) of China
- Zhou Shengxian, Minister, Ministry of Environmental Protection of China
- Zhu Hongren, Member of the Leading Party Members' Group and Chief Engineer, Ministry of Industry and Information Technology (MIIT) of China
- Professor Jiang Mianheng, Vice President, Chinese Academy of Sciences & President, CAS Shanghai
- Rohit T. Aggarwala, Director of Long-Term Planning and Sustainability, City of New York Mayor's Office of Operations
- Ross Donaldson, Global Managing Director, Woods Bagot
- Han Wenke, Director General, Energy Research Institute, National Development and Reform Commission (NDRC) of China
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- C.K. Kho, Executive Chairman, Lian Huat Group
- Wang Wenjing, Chairman & President, UFIDA
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Etc. One True Thing



A Cornell University study found office workers were most productive at a temperature of 77F.

The Women's Office Sweater

A soft, stylish knit for the overly air-conditioned workplace

The Want: Hot weather plus extreme AC creates the need for a medium-weight sweater that goes with everything. It needn't cost much, and it must offer style along with utility.

The Get: Anthropologie's Shadowsleeve Cardigan by Moth ($78 at anthropologie.com), an airy gray knit, is snappy enough to upgrade any outfit. The soft rayon blend doesn't wrinkle, ensuring that it looks fresh even after a long week. Bonus fashion points for the elegant drape and tonal gray-on-gray stripes that subtly separate it from boring basics. B
—*Doria Santlofer*

UNDER-DESK NECESSITIES

Net-A-Porter Buying Director Holli Rogers' suggested office accessories:



Gold Cuff

All you need to go from work to a swanky client dinner; adds a wow factor to an otherwise simple silhouette.



Taupe Ballet Flats

Maintain an office elegance while matching everything; plus, they're easier to run around in than pumps.



Wide Belt

Wrapping one around a plain suit or business dress instantly prepares you for a night out.



Gift

For last-minute birthday or thank you packages, Smythson's charming leather-bound notebook ($69, smythson.com).

SWEATER: PHOTOGRAPH BY NIGEL COX FOR BLOOMBERG BUSINESSWEEK

Etc. Next Life

The Italian Dream Job

"There are a million laws in Italy ... so you follow the ones you actually go to jail for," says John Voigtmann



When a record exec saw his industry under siege, he built a new life—and hotel—in Tuscany

Navigating Italy's bureaucracy is not for the faint of heart. Then again, neither is getting Christina Aguilera out of her dressing room on time. "My old job was to contain stars who were exploding," says John Voigtmann, former VP of International Marketing at Sony, where he was responsible for acts such as Maroon 5, The Strokes, and, yes, Aguilera. "It was," he pauses, "frustrating."

In 2001, while looking for a wedding location in Europe with his fiancée, *Condé Nast Traveler* contributor Ondine Cohane, Voigtmann stumbled upon a villa in the Val d'Orcia, a stone's throw from Pienza, Tuscany. The villa was in ruins. Abandoned since World War II, it was owned by a Sardinian sheep farmer who kept his pigs at the property. After four more years at Sony, Voigtmann quit his job in 2005. He and Cohane moved to Pienza, learned Italian and, one year later, paid 450,000 euros (approximately $565,000 U.S. at the time) for the villa. It took another year and another 1.3 million euros to transform it into the midcentury modern boutique hotel that Tuscany lacked. The idea was to create a hip alternative to the area's nostalgia; it would even have an infinity pool. He called it La Bandita.

There were more than a few hurdles. The villa lay in a Tuscan park that just happened to be a Unesco world heritage site. "Even the earth was protected," Voigtmann jokes. Forget adding a pool; authorities told him he couldn't even renovate the pig house.

Utilizing the sangfroid that helped him navigate the music business, Voigtmann had a park surveyor testify that the pool site lay outside park boundaries, and Voigtmann explained that he was spending $1 million to repurpose the pig house. "There are a million laws in Italy," he says. "You can't follow all of them, so you separate the ones you actually go to jail for and follow those."

The eight-bedroom hotel, which opened in May 2007, has been so successful that Voigtmann recently purchased another property in a nearby village to keep up with the heightened demand. For now, the former pig house, which starts at 395 euros a night in the high season, is booked solid. —*Ryan Bradley*

Guests watch farmers tend their flocks over drinks at La Bandita



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FROM TAMING EGOS TO TACKLING BUREAUCRACY

Amount spent on La Bandita renovation (new roof, new floor, new electrical and plumbing): €1.3 million

Estimated hours spent dealing with Italian bureaucracy: 2,190

Kilometers of pipe required to reach nearest water supply: 6 (nearly 3.75 miles)

Number of human neighbors vs. sheep neighbors: 2 vs. 740

Number of bottles of Brunello drunk since opening: 1,420

Amount spent on new property: €1.5 million

Expected cost of renovations to new property: €1.75 million

Sony salary: $300,000 a year

New salary: €60,000 a year, plus a house, a car, and "all the brunello I can drink (literally)."

Price of a stay in the Pig Sty Suite: €395-€495 per night

DATA: LA-BANDITA.COM

VOIGTMANN: PHOTOGRAPH BY MARCO DI LAURO FOR BLOOMBERG BUSINESSWEEK

Art Basel

How to do the must-see shows and the hippest spots like an art-world savant

For one long weekend every summer, Art Basel turns a somnolent Swiss town into the world's art-trading capital. Last year a record 61,000 visitors got a snapshot of the market and a chance to rub shoulders with the cognoscenti who anoint the art world's Next Big Thing.

Fairgoers spend a day or two at the main attraction, a sprawling hall where the hottest booths will hawk pieces by minimalist Dan Flavin, Korean sculptor Do Ho Suh, and the legendary Louise Bourgeois. Smaller side fairs like Liste draw shoppers looking for newer names, while the youth-driven Volta fits right in with its edgy home in Basel's Dreispitzhalle neighborhood. People looking to be seen book tables at Chez Donati or the Restaurant Kunsthalle; those wanting an unencumbered meal settle for the casual Bodega zum Strauss. This year there's an added element to the fair: Art Parcours, 10 large-scale works installed throughout the city.

In preparation for this year's fair, scheduled for June 16-20, *Bloomberg Businessweek* asked insiders to share the sights and scenes that have proven worth their while. Ⓑ —*Lindsay Pollock*

Alternative Fair



Liste shows avant-garde work by young artists in a labyrinthine former brewery. It attracts hipster gallerists sporting asymmetrical haircuts and cool specs, and it's not everyone's favorite: "Liste is a place to discover new talent, but it's in a tough setting that's not so flattering for the art" says art adviser Wendy Cromwell.

Benchmark Sale



In 2009, Art Basel's most-buzzed-about sale was a collaboration between musician Pharrell Williams and Japanese pop artist Takashi Murakami; the duo's ***The Simple Things*** (left) sold for $2 million within 20 minutes of the show's opening.

Art Panels



Shock-master performance artist Paul McCarthy and veteran dealer Irving Blum—one of Andy Warhol's first fans—engage in battles of wits as part of the **Conversations** series hosted by fair organizers.

Dinner Scene



Dealers and fellow *éminences grises* drink negronis at **Restaurant Kunsthalle**: "Go for the atmosphere, the Italian-Swiss cuisine, the service, and the great alfresco terrasse," says Brussels-based dealer Rodolphe Janssen.

Major Talking Point



New work by 99-year-old **Louise Bourgeois.** Although the French-born sculptor is known for 30-foot metal spiders, she's now showing the fabric composition (above) at the booth of New York gallery Hauser & Wirth.

LISTE: HECTOR ZAMORA AND LABOR, MEXICO D.F.; MURAKAMI: (C)2008-2009 TAKASHI MURAKAMI/KAIKAI KIKI CO., LTD. ALL RIGHTS RESERVED; BLUM: PATRICKMCMULLAN.COM; MCCARTHY: CHRIS JACKSON/GETTY IMAGES



Cool Off



Basel summers can be steamy, and some hotels lack air conditioning. Locals typically jump in the Rhine to cool off. (They change into swimsuits and float their clothes beside them in plastic bags.) "It's very clean and has a nice current," says Art Basel exhibitor Friedrich Petzel. "You just glide, and let the current take you.... If you are not completely drunk, you survive."

Gallery Hopping

Basel trams are famously punctual



Armani-clad dealers, billionaire buyers, and blue-jeans-wearing artists all clamber aboard the ultra-efficient **BVB** light rail. "It's Basel's greatest asset," says art adviser Lisa Austin.

Fancy Hotel



A martini at the hotel bar will set you back $30

The glitzy **Three Kings** hotel might be booked solid, but cocktails, though pricey, are still available at the hotel's riverfront bar.

Quick Bite



+



"I highly recommend two national Swiss grocery chains: **Migros** and **Coop**." —Katja Zigerlig, director of fine art insurance for private AIG clients

Hotly Anticipated Show



Curatorial powerhouse **Fondation Beyeler** presents a comprehensive Jean-Michel Basquiat exhibit of 100 works including Basquiat's *Untitled (Boxer)*, above, which sold for $13.5 million in 2008. "It's the greatest Basquiat show of all time," says collector Adam Lindemann. "And the most important thing to see in Basel, full stop." The museum itself is an airy Renzo Piano design plunked between cow pastures. "The location and light are beautiful, and the shows are always inspiring," says dealer Claudia Altman-Siegel.

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Invest in



Barreling Toward Peak Oil

Energy analyst Charles Maxwell of Weeden & Co. recommends Canadian tar sands plays

The amount of oil consumed in the world is unbelievable—85 million barrels a day. And we are not making more of it.

People throw around the term "peak oil," but that doesn't mean the system will run out of oil. It means the amount of oil you're gaining by finding new oil fields—and bringing them onstream—is equal to the losses you're taking as other fields run down. The U.S. was the first country to peak in 1970, but that was a seamless transition since the oil companies just brought in more oil on tankers. Now the U.S. is importing about 67 percent of its oil.

The business of peaking is now usual: There are 30 non-OPEC countries with significant production. Thirteen of these have peaked or are about to peak, and they contribute some 52 percent of the oil volume outside OPEC.

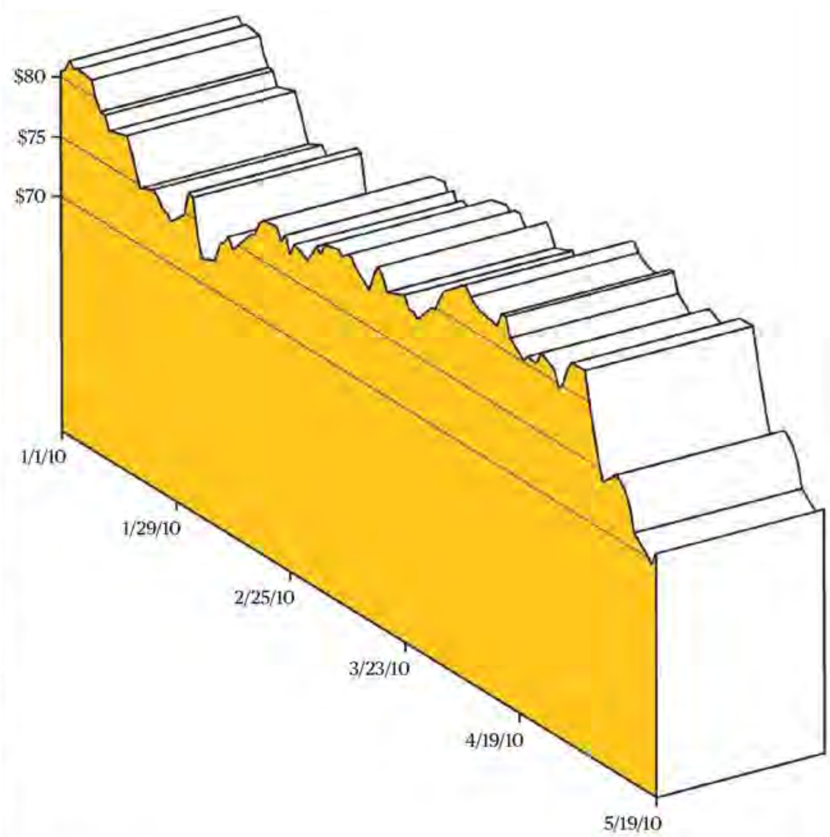
World oil production will peak sometime between 2015 and 2020. The plateau should last for three to five years. The price will go up, since the supply isn't rising and demand will be strong. That will scare people.

Wall Street hasn't accepted yet that the oil reserves are so limited. I think oil will reach at least $150 a barrel around 2015; it could go to $300 by 2020. In the short term, my forecast for 2010 is $77 a barrel. (For 2011, my forecast is $75 a barrel.) I can't see an apparent good reason why oil rose from $67 last September to $87 this April. I'm not surprised oil prices are back down—the market was self-correcting.

There are 50 corporate oil companies around the world that matter to Wall Street. I particularly like the Canadian companies with strong presences in the oil sands of northern Alberta: Suncor and Cenovus Energy. Both companies hold well over 50 percent of their assets in the form of oil sands reserves. Both will not stop producing incremental barrels of oil in 2012, or 2015, or 2020, but will be able to travel into at least the 2030s—well beyond peak oil, as no other major can. Both companies will also have improving profit margins.

There are a number of reasons I favor Suncor and Cenovus over, say, ExxonMobil or Marathon.

CRUDE OIL PRICE — **Maxwell forecasts oil at $77 a barrel for 2010**



DATA: BLOOMBERG

World oil will peak between 2015 and 2020 ... it will reach $150 to $300 a barrel

Over the past nine years Exxon has not been able to grow its crude production, compared with around 7 percent annual growth for Suncor. Exxon is struggling with a world where labor costs, taxes, equipment, and other capital costs are up. In the past it could lay off higher costs with high volume. Now Exxon cannot.

Oil companies with long-lived reserves will be highly profitable as both prices and volumes rise over the next decade. Among midsized exploration and production companies, ones like Devon Energy, EOG Resources, and Apache could be included. Among oil services companies, Halliburton should be one of the biggest winners.

—As told to Christopher Farrell

The Stats: Charles Maxwell started in the oil industry in 1957, working for what is now ExxonMobil for 11 years. In 1999 he joined institutional brokerage firm Weeden & Co., where he is senior energy analyst.

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The Dell Women's Entrepreneur Network

June 20–22, 2010 USA Pavilion, Shanghai

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Tony Hsieh

"Right after the dot-com crash... it was hard for us to persuade anyone to fund this crazy concept of selling shoes online"

The founder of Zappos on revising his business model and, in the process, revamping his company amid a crisis



We had started as a middleman, collecting orders from customers and then having other companies fulfill those orders. The idea was to form partnerships with hundreds of brands and feed their warehouses to customers. It's called drop ship and, on paper, it's a great business model. You don't have to manage the inventory or take on any of the risk.

In 2003, right after the dot-com crash, a lot of e-commerce companies were going out of business or were on their way. It was hard for us to persuade anyone to fund this crazy concept of selling shoes online, and about 25 percent of our revenue at the time was coming from drop ship. But we decided to end it. Even though it was hard to walk away from sales at a time when nobody is offering you money, we couldn't distinguish ourselves in the eyes of our customers if we weren't going to control the entire experience. We had to give up the easy money, manage the inventory, and take the risk.

We asked ourselves what we wanted this company to stand for. We didn't want to sell just shoes. I wasn't even into shoes–I used to wear a pair with holes in them–but I was passionate about customer service. I wanted us to have a whole company built around it, and we couldn't control the customer experience when a quarter of the inventory was out of our control.

We knew we had to stop doing [drop ship]. It was as if it were a drug. Over the long term, it was critical that we were handling the merchandise ourselves. This was the toughest decision I've had to make. We couldn't build a brand around customer service if we couldn't deliver it. When we had the goods in our control, we were able to do so much more.

Once we made that decision, all the other decisions became easy. We had already given up a lot, but we knew what we stood for at that point, and our employees could see that we were serious about this. That made all the difference.

—As told to Diane Brady

PHOTOGRAPH BY MIKE McGREGOR FOR BLOOMBERG BUSINESSWEEK



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